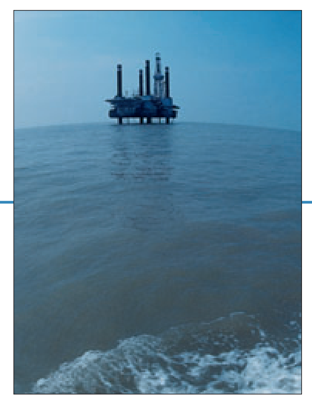
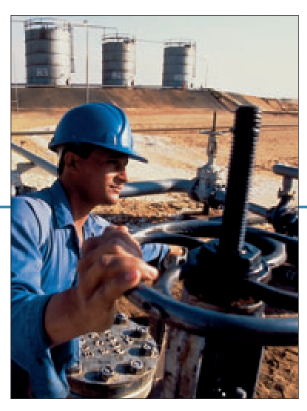
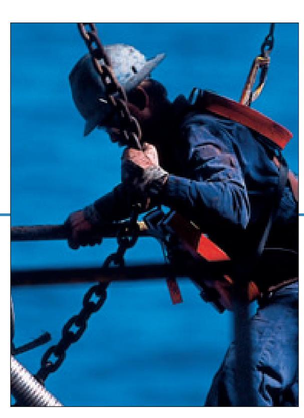
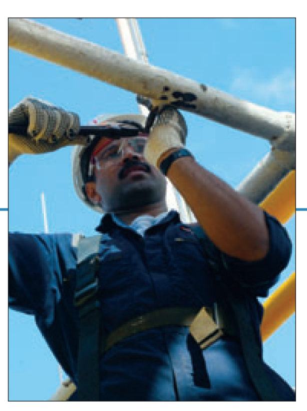
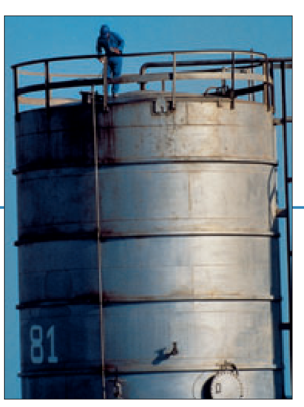
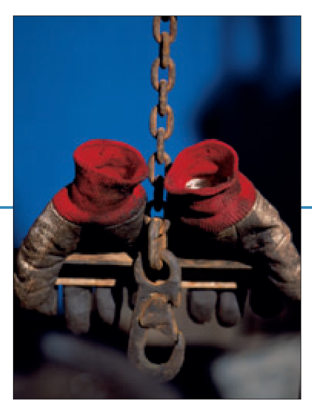
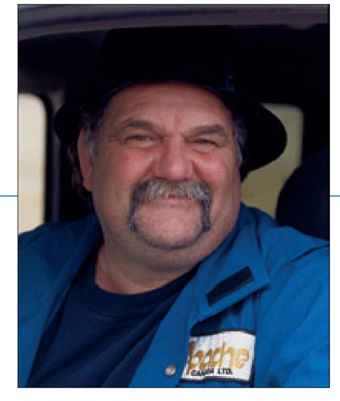


CRITICAL MASS: Apache at 50





CRITICAL MASS: Apache at 50

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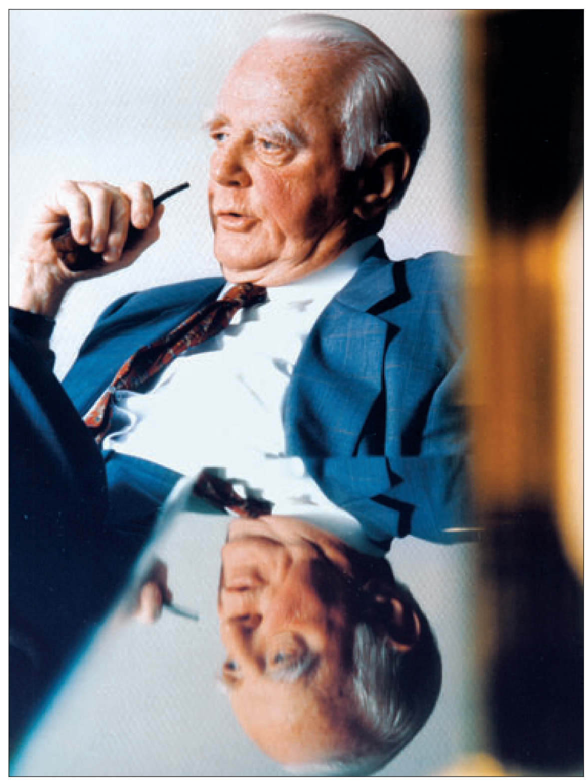
FOREWORD



Raymond Plank, Chairman and Founder

Apache Corporation was conceived 50 years ago. Its gestation, with no small amount of planning, has yielded a company that is Built to Last.

When I, the surviving member of Apache's three founders, returned from World War II serving as a combat pilot in the South Pacific and finished my college stint at Yale University in 1946, an early motto was "beaten paths are for beaten men." It fit then because I wanted to start a business rather than join one.

Brooks Fields, a fellow Yale classmate from Minnesota, used his several remaining months at Yale to research potential opportunities for us to combine our aspirations by working together.

Our rationale, albeit questionable at the time, was simple and straightforward. We believed that pent-up demand both from the war and the Depression, plus the prospective baby boom, would unleash the energy of returning veterans and women desiring to enter the workforce. Many of our generation felt urgency, confidence and commitment.

We believed that the formation of new small businesses would be a significant accompaniment to rebuilding America. We also believed that the requirements of the bureaucracy in the fields of keeping records, filing tax returns and deducting withholding and Social Security taxes were challenges to provide for and endure but not to relish. We struck our claim. I went to night school, supplementing college economics courses with the study of accounting and income tax. Brooks and I hustled up customers. While growing, our tiny business was anything but lucrative. Brooks ultimately headed for the grain business and higher take-home pay. I borrowed the funds to buy him out and lived at home a bit longer.

Another opportunity paralleled the cessation of the war. History has often correctly reported that America floated to victory on a sea of oil. America's oil fields contributed the energy not only for the American military, but also for the British and our allies in the Far East, principally Australia.

Needing to rejuvenate its domestic reserve base, the United States created tax incentives (the highest marginal rate was then 91 percent) to stimulate war-delayed development and exploration. American industry and individuals responded, and the market for energy investment blossomed. I remember exposing the princely sum of $350 for my first direct investment in oil, and the well produced in commercial quantities. My primary interest, however, was in handling the accounting and associated tax work for local investors.

Malfeasance on the part of early oil promoters in Minnesota was rampant. Local investors threw them out and asked that my associates and I assume managerial responsibility. Faced with this opportunity, I needed a long-term vision and a planning concept. The latter would contain four principal elements:

First, rather than sell highly taxed individuals and privately held corporations interests in individual prospects, we would offer them an interest in the form of units in an annual multi-property drilling program.

Second, we would form a small and initially privately held company staffed by professional geologists, engineers and landmen working for the investor and against the sweeping variety of conflicts of interest which were then prevalent and which I held to be in contempt of integrity.

Third, our commission on investors' dollars would be fair and transparent to provide a competitive edge. We would cover our costs for general and administrative overhead and assume responsibility for drilling, completing and producing the oil and natural gas. We would profit by retaining a percentage of the oil and natural gas sales revenue after the investors recovered their costs.

Fourth, we would develop a professional sales force to sell our programs across the country. Sales persons would receive a five percent commission and the program would retain the remaining 95 percent of funds raised.

Thus armed, Apache was born on December 6, 1954.

Our concept quickly revolutionized the sale of oil and gas programs. Our first loyal investors coughed up $250,000 at $10.00 per share to capitalize the young company. I borrowed $5,000 to own 500 shares. There were no promotional or free founders' shares.

As I write, Apache's shares are trading on the New York Stock Exchange at levels in excess of $50 per share. That relates to an original cost, adjusted for stock splits and stock dividends, of but 4.4 cents per share.

Fifty years ago, and upon its formation, the market value of Apache was $250,000. Today it stands above $16 billion.

There have been many speed bumps along the way. Yet over our half century Apache has been and remains a growth company in the world's largest industry.

We began our run for the roses with the simple concept of becoming a significant and profitable oil company for the benefit of our shareowners, co-workers, society and the United States of America.

Our long-term values have proven integral to Building to Last. While words such as integrity, morality, strong work ethic, sense of urgency and focus may appear trite to some, they hold depth of meaning to fellow Apaches casting shadows into the future.

A former president of Apache and now, years later, a fellow director, Mick Merelli, once said, “Plank, say what you will, but Apache has been highly successful in having the right people in the right place at the right time.” One such person is Steve Farris, who joined Apache in 1988 and succeeded me as CEO in 2000. With that succession in place, he’s leading a great Apache team.

John Kocur, who climbed from staff attorney to general counsel to president, points to the strategic significance of the era of Apache’s diversification — when we owned and operated 58 separate businesses. How well he knew that when state regulations constrained oil production by 90 percent, our program business was on the death list. Our company refused to die, however, because we searched for and found another way to maintain and add value.

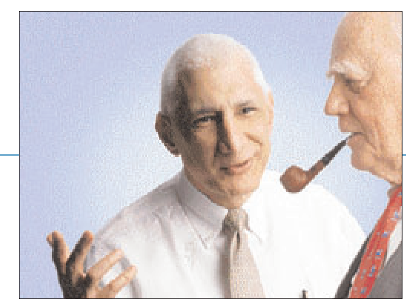
We utilized our common stock to acquire successful, entrepreneurially driven small businesses to keep Apache growing. John points to those years of diversification as the key to Apache’s survival. The individual entrepreneurs were Minute Men driving Apache’s growth until oil and gas displayed long-term viability for us. Many of these heroes survive today as wealthy Americans.

John knew the strategy and the conflicts along the way. “Apache,” he said, “never left the oil business. When the industry cycle changed, we were prepared and had the capital, the people, the will and the discipline to develop the Apache legacy in oil and gas. We organized to build the business through the interests retained in the program wells drilled. When the road was blocked, we detoured around the avalanche and accelerated our tempo of growth.”

David Higgins has turned his fine mind, recollection and study to telling that story of accomplishment and legacy on the pages which follow.

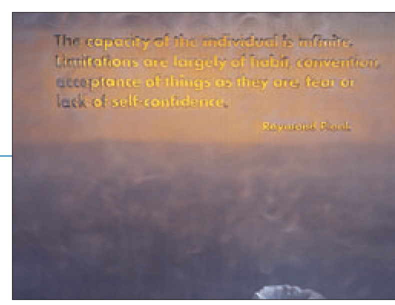
Raymond Plank

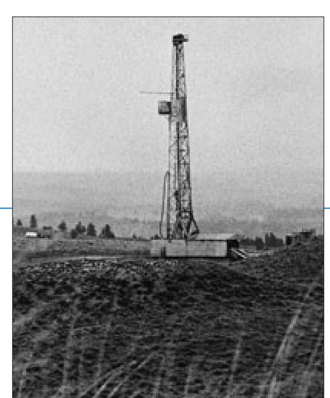
Raymond Plank, *October 15, 2004*



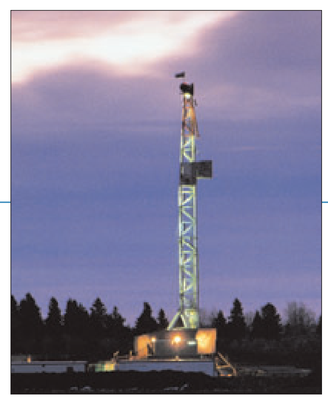
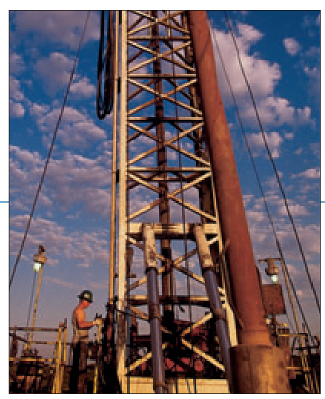
GENERAL STORE
RECLUSE PETROLEUM CLUB

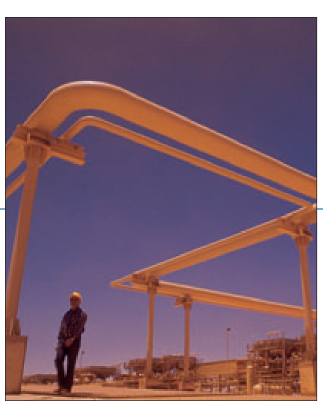
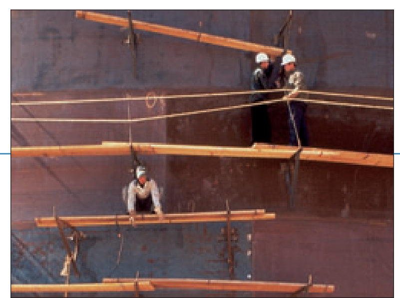
APACHE

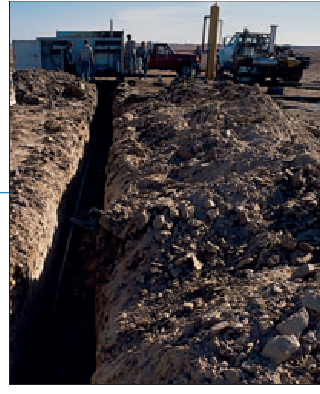

The capacity of the individual is infinite.
Limitations are largely of habit, convention,
acceptance of things as they are, fear or
lack of self-confidence.
Raymond Plank

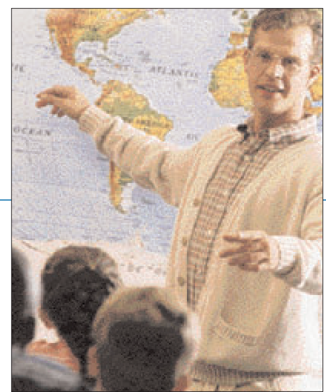


APACHE CORPORATION




ATLANTIC
OCEAN

INTRODUCTION

Critical Mass: Apache at 50 is the third in a series of histories on the global oil and gas independent that sprung from a small, post-World War II accounting service in Minneapolis, Minnesota. Its predecessors, *Journey Into Risk Country* and *Against the Grain*, told the story of the company on anniversaries 30 and 40.

Critical Mass takes a different approach than either of the first two volumes. It is organized into three distinct sections: a 10-year history, 50 defining events and a summary of natural gas markets and Apache's role in efforts to reform them. The 10-year history, covering the period 1995 to 2004, actually begins with certain seeds planted in the 1980s. The defining events, beginning with the founding of the company in 1954, strive to make the connections, large and small, that link the company initially capitalized with $250,000 to that which today has a market value in excess of $16 billion. The section on natural gas markets tells the story, as yet unfinished, of the debacle for which the name Enron has become synonymous, and Apache's role in fighting for market integrity and transparency.

Critical Mass attempts to minimize repetition, not only within the third volume but also between itself and the first two. While this chapter of the Apache story is written to stand on its own, it is part of a complementary suite of histories. It should be read as such.

Raymond Plank and Joseph Kingman, First National Bank, Minneapolis

PERSPECTIVE

Apache Corporation, founded in 1954, spent four decades priming the pump for its fifth. It did so by recognizing opportunity and growing shareholder value with a laser-like focus on profitability. It did so by diversifying away from oil and gas, so much so that the original Apache Oil Corporation removed "oil" from its title. And it did so by ultimately returning to its roots. At its core, in its heart and from its inception, Apache was, and always has been, an oil and gas company.

In 1987, the one-time mini-conglomerate shed its last non-oil-and-gas subsidiary, formally withdrew from the business of creating oil and gas investments and announced its intent not only to restructure as a pure exploration and production company but also to enter the international arena. For the next seven years, through the course of headquarters relocations from Minneapolis to Denver and from Denver to Houston, the "new" Apache brought a refined and often contrarian approach to building an independent oil and gas company with sufficient critical mass to survive and thrive well into the 21st century.

In 1994, with the ink drying on the company's 40-year history, *Against the Grain*, Apache completed its second full year in Houston. Most of the remaining public drilling funds, the last vestiges of the original Apache, were soon to be dissolved. The evolution of Apache from an oil and gas investment manager to an oil and gas company was virtually complete.

Replacing the "old" Apache was a primarily domestic entity, growing in some years through acquisition and in others through the drill bit. Its sense of purpose and direction were well-defined and an international path to future growth had been chosen. Desired results had yet to materialize but seeds had been planted and progress had been made. Optimism, both in the future and the Apache model, was abundant. "*We remain firm in our belief that the dynamic forces which affect our business present opportunities for those with the proper strategies,*" said Raymond Plank, Apache's chairman and founder.

Whether in terms of reserves, production or capitalization, Apache ranked among the top independent oil and gas exploration and production companies in the United States.

In early 1995, the company reported annual earnings of $43 million on record oil and gas sales of almost $500 million. It had a market capitalization of $1.5 billion, record reserves of 269 million barrels of oil equivalent (MMboe), 96 percent of which were in the United States, and record daily production of 108 thousand barrels of oil equivalent (Mboe).

Overall profitability was no small achievement as average 1994 natural gas and oil prices languished below $2.00 per thousand cubic feet (Mcf) and $16.00 per barrel, respectively. Domestic supplies of natural gas were perceived to be so abundant as to be nearly inexhaustible and world oil markets were still sorting through issues that ultimately would see average prices decline to $10.00 per barrel before rebounding.

Seven years into the international experiment, the Lower 48 remained the company's profit center and the springboard from which Apache pursued its goal of global growth. Of the 316 wells the company drilled in 1994, only five percent were outside the United States.

Domestic operations were focused in the Mid-continent, the Permian Basin, the Gulf Coast, the Gulf of Mexico and the sprawling Rocky Mountains.

Internationally, the company had a base of operations in Western Australia's Carnarvon Basin as well as initial new-field discoveries in Egypt, China and Indonesia.

Growth had come from the ongoing exploitation of properties acquired from MW Petroleum in 1991.

Management's focus was to contain costs, strengthen the balance sheet, reduce debt from levels approaching 60 percent of capitalization and continue the steady growth of the company's international portfolio. Domestically, and in order to enhance market value for the producer, the company sought to pursue initiatives to change the way natural gas was marketed. The ultimate goal was to build an Apache that would last by building long-term value for shareholders.

Fast forward nine years. At the beginning of 2004, the company's 50th year, Apache reported 2003 earnings of $1.1 billion on total revenue of $4.2 billion. It had a market value of $13 billion, record reserves of 1.66 billion barrels of oil equivalent and record daily production of 423 Mboe.

Average natural gas prices rose to $4.61 per Mcf, largely on the strength of recognized supply shortages in the United States. Average realized oil prices, reflecting the turmoil of the War on Terror and OPEC's production discipline, continued their five-year climb, reaching $27.76 per barrel. Both pricing thresholds marked Apache records.

The Lower 48, still the heart of Apache's portfolio of core areas, remained the company's largest single cash flow generator. But activity had moved elsewhere. Of the 1,449 wells drilled in 2003, only 20 percent were in the United States. The Rocky Mountain region, earlier hampered by relatively unfavorable economics, had long since been sold, bringing increased emphasis to the Mid-continent, the Gulf of Mexico, the Gulf Coast and the Permian Basin.

Internationally, the company had profitable core areas in Australia, Canada, Egypt and the United Kingdom portion of the North Sea. China and Argentina had established production. Based on reserves, Apache's foreign subsidiaries represented 56 percent of the company.

Growth in 2003 came through acquisition, exploitation and exploration. Purchases in the Gulf of Mexico from BP and Shell and in the UK North Sea from BP topped the list of $1.6 billion in acquisitions. Exploitation of the Gulf packages began at mid-year while operations in the North Sea focused on facilities upgrades prior to the commencement of a drilling program in early 2004. A thousand-well exploitation program in Canada added organic growth of 80 MMboe. Exploratory success in Australia expanded Apache's area of operations southwest from the shallow waters around the Varanus Island hub to the deeper waters of the Exmouth Basin. An exploration well, the Qasr 1-X, on the Khalda Offset Concession in the Western Desert of Egypt was appraised as the largest and most significant onshore gas discovery in Apache's history and, for that matter, in the history of the Western Desert.

Also in Egypt, the company signed a Memorandum of Understanding with the government regarding the development of its 2002 discoveries in the deep Mediterranean waters off the Nile Delta.

Management's focus, beyond the necessary integration of the acquisitions, was to contain costs, maintain the company's strong, investment-grade ratings, and remain committed to its programs of corporate social responsibility. Domestically, and in the wake of the energy traders' collapse, the company continued seeking measures to bring transparency to the way natural gas is marketed so as to enhance and preserve value for the producer. In a dynamic environment that required adaptability, the primary goal remained unchanged: Build a company to last by creating long-term value for the shareholder.

Noting the repetition, an outside observer might say: "The more things change, the more they remain the same." He or she would be inaccurate. With the exception of its continuing reliance on the initiative of its employees, Apache at 50 bears little resemblance to its 40-year-old predecessor. It has faced countless and ever-evolving challenges, many of which put other talented companies out of business. It has survived because it has developed, and is driven by, a strong culture consisting of talented individuals with an even stronger bias toward achievement.

Apache's fifth decade, on a broader scale and stage than any of the first four, is the story of that culture and the high degree of achievement of those individuals.

SETTING THE STAGE: 1982 — 1994

Apache Corporation is an oil and gas program, exploration and production company with industrial and agricultural operations.

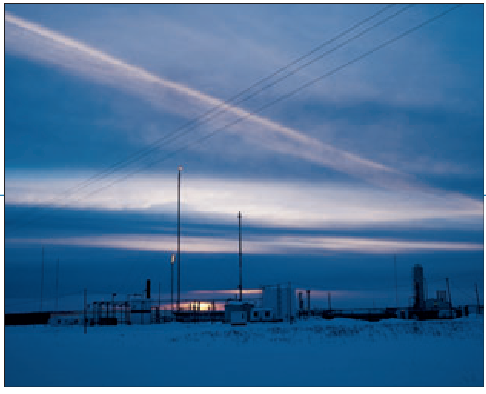
Apache Corporation 1982 Annual Report

In the current era, almost every year at Apache has been an improvement over its immediate predecessor in the financial and operational measurements that matter most. There are stories of year-to-year growth and the company's relentless march forward, both of which mark high degrees of achievement. There is another story, however, involving historical context and the underlying strategies that created the environment for the success that followed.

To best appreciate the tale of Apache's fifth decade and the course the company sets at the beginning of its sixth, it helps to understand that it is not Apache's purpose simply to achieve, but rather, to continue achieving. That requires a longer term view and the identification of strategies set in the past and adapted over time. The last 10 years at Apache are the product of forces set in motion in the early 1980s, well before Apache began the restructuring that led to today's independent exploration and production powerhouse.

If the "new" Apache was born in 1987, it was conceived a few years earlier.

Major and mid-level integrated companies recognized 20 or more years ago that the United States was becoming one of the most mature hydrocarbon provinces in the world, both in terms of the number of wells drilled and the volume of reserves yet to be discovered and recovered with ever-improving technology. They felt it inevitable that future exploration and development would yield ever-smaller reserve targets at ever-increasing finding and development costs and, with each passing year, the United States would be less able to satisfy steadily growing domestic demand for energy.



In response, those same companies began rationalizing their domestic assets and redeploying capital internationally in the never-ending search for large reserve targets. This exodus presented domestic acquisition opportunities for an Apache whose low-cost operations generally allowed it to remain profitable and grow when the majors found it increasingly difficult to do so. Between 1982 and 1986, several years before “acquire and exploit” and “critical mass” were identified as such, Apache and its affiliates added reserves, production and drilling inventory through proportionately large and strategically important acquisitions from Dow Chemical Company, Davis Oil Company and Occidental Petroleum.

The organic growth arising from these transactions had a multiplier effect on annual cash flow available for reinvestment and simultaneously underscored the increasing difficulty, particularly in light of volatile commodity prices, of reinvesting capital to achieve annual growth targets in a mature hydrocarbon province. By 1988, Apache was convinced of the long-term merit of international diversification. Committing up to 10 percent of its annual capital budget, the company formally declared its intent to search for areas outside the United States in which it could grow and operate profitably. Strategically, the company was ahead of its time and its competitors.

The seeds of two intertwined concepts had been planted, shaping Apache’s understanding of itself and its mission. Although becoming clear only over time, these concepts defined the choices Apache faced in the late 1980s, the direction it took in the 1990s, and the forces that have driven it into the new century:

- In the United States, Apache would be an exploitation and production company growing primarily through acquisition.
- Outside the United States, Apache would be an exploration, development and production company acquiring and developing core areas to complement its U.S. base of operations.

The beginning of the story of the domestic acquirer with international aspirations was inauspicious. In 1987, following the previous year’s oil and gas price collapse, Apache recorded a net loss from continuing operations of $80 million. A manager of oil- and gas-related investments for 33 years whose

own assets were less than total assets under management, the company was busy restructuring into a pure exploration and production play. With Wall Street unable to determine with any certainty either what Apache was or what it was trying to be, the stock traded near historic lows. Oil and natural gas prices wallowed at low levels without hint of recovery. Management, setting an aggressive target of $5 million in earnings in 1988, recognized that the very existence of the company was at stake.

Betting on survival, Apache hired Francis H. "Mick" Merelli and G. Steven Farris in 1988. Mick, as president, brought to Apache a gentle demeanor behind which was a razor-sharp understanding of the business; Steve, as vice president of exploration and production, contributed an encyclopedic attention to detail; together, the two implemented operational management and incentive systems that proved critical to Apache's successful restructuring (and remain Apache hallmarks today).

Ultimately, it was Mick and Steve's aggressive development of the Occidental properties acquired in 1986, and the application of their systems to that development, that provided the necessary spark for Apache's recovery. Moderate price improvement didn't hurt. The $80 million loss was reversed with earnings of $5.4 million in 1988. Income quadrupled to $22.1 million in 1989 and doubled again to $40.3 million in 1990. Reserves over the same period doubled to just over 100 MMboe and asset values of $503 million at the end of 1987 grew 65 percent to $830 million. Improved financial results brought with them a strengthened balance sheet.

With a newly found degree of discretionary cash flow, Apache drilled two international wells in 1989. As with most new undertakings, success was not immediate. A wildcat in Argentina was dry, as was a highly prospective well offshore Aruba that tested the northern extent of Venezuela's world-class oil reserves. Subsequent ventures into France and West Africa proved equally fruitless.

With no international reserves on the books, domestic acquisition and development were the company's lifeblood. Step change, in the form of an acquisition from Amoco that replenished the company's drilling inventory and propelled growth through the early 1990s, came in 1991.

Apache had previously learned that Amoco hoped to sell certain domestic operations housed under its subsidiary, MW Petroleum Company. Amoco had conducted an auction for the properties but no sale occurred. Without the pressure of an auction, Apache negotiated a one-on-one transaction.

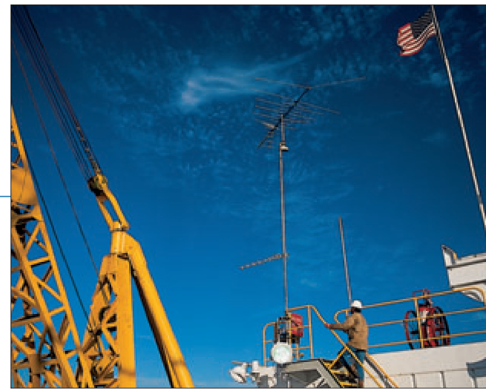
Working in full knowledge of the benefits that might accrue to a growing independent that demonstrated its ability to negotiate and close a transaction with MW, Apache ultimately acquired interests in more than 6,000 wells, near-countless drilling locations, numerous enhanced recovery projects and over one million acres of developed and undeveloped leasehold. Most of the new properties complemented Apache's existing regional positions. With the stroke of a pen and the expenditure of $546 million, Apache doubled its size and shifted its center of critical mass from the Mid-continent to the Gulf Coast.

Of strategic importance was the relative balance that the MW acquisition brought to Apache's gas and oil reserves. Historically heavily weighted toward natural gas (80 percent), Apache saw balance as a hedge against price volatility. The acquisition, changing the gas-to-oil ratio to 60:40, was the first step toward an approximate 50:50 equilibrium maintained to this day.

As important as the MW acquisition was to Apache's ability to grow, it also gave birth to the idea of "acquire and exploit": Buy a large pool of older, domestic properties from the majors; sell those deemed non-strategic and use the proceeds to lower debt; then exploit the remaining properties to recover reserves either undiscovered or considered uneconomic by larger, higher-cost operators. So successful was the acquisition and exploitation of MW that "acquire and exploit" became Apache's mantra for the balance of the decade and into the next century, opening doors for global transactions with Texaco, Shell, Repsol, BP and ExxonMobil, to mention but a few. Today, with volatile pricing leading to the use of hedging to protect the investment in its early years, "acquire and exploit" has become an industrywide expression for Apache's much-copied strategy.

Providing the aggressive and talented drilling team developed by Merelli and Farris an inventory of exploitation and development opportunities, the MW acquisition virtually underwrote domestic growth through 1994. Reserves that began the decade near 100 MMboe grew two-and-one-half times to 269 MMboe, only four percent of which was outside the United States. Like reserves, production reached record levels, as did the count of wells drilled and completed. Asset values that first reached $1 billion in 1991 nearly doubled. And, of course, discretionary cash for international expansion multiplied.

Lost in the shuffle was Apache's relatively small acquisition of producing properties in the Carnarvon Basin offshore Western Australia. At the end of 1991, Australia became the first of Apache's international subsidiaries to have reserves, production and a toehold from which the company could explore. It gained a measure of critical mass two years later through a merger with Hadson Energy Resources Corporation that brought with it operations, infrastructure, personnel and a natural gas market about to emerge from deregulation. Most important, Apache finally had an international base of operations that had real potential for growth.



The following year, Apache participated in new-field discoveries in Egypt and China, setting the stage for stories that are still unfolding. Equally important, Apache was beginning to refine its international strategy. With the exception of Australia, where the company was developing a sense of critical mass, Apache's early approach to foreign expansion generally meant small positions in many countries. A seemingly random, well-by-well, prospect-by-prospect approach had, to this point, been largely unsuccessful.

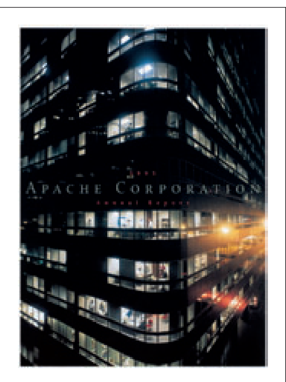
Apache determined that, in any country it entered, there must be a significant presence and a sense of existing critical mass which, in tandem, would provide "running room" for exploration and development from the beginning of any new international undertaking. This would limit the countries Apache might find prospective but would enhance the potential for future growth and success. It was a growth strategy that had worked in the Mid-continent's Anadarko Basin. The hypothesis, however, still needed to be tested abroad.

By virtually all measures, the Apache that celebrated 40 years in 1994 was a successful and profitable independent. It had grown its assets five-fold since turning 30 and its reserves nearly twice that. Yet year after year it was forced to struggle against the immovable wall of relatively stagnant commodity pricing. Try as it might, it could not grow earnings materially beyond the levels it had achieved in 1990, bouncing year-to-year on either side of $40 million. It had little more than potential to show for its years of international effort. As assets grew, so too did debt, from $195 million in 1990 to $658 million in 1994. The debt-to-capitalization ratio was just under 45 percent. It was destined to go higher.

While not obvious at the time, Apache had put in place all the necessary pieces for continued growth and expansion. It had a firm commitment to staying the course on its long-term plans for expansion abroad. Its domestic strategy of "acquire and exploit" was gaining credibility and recognition in the marketplace, giving it potency as yet unquantified. Positive developments were about to occur and forward-looking strategies were about to bear fruit.

THE BEST
SAFETY DEVICE
IS A
CAREFUL
MAN

THE STAGE



1995

The Apache that entered its fifth decade was a seasoned domestic operator, well versed in the innovative risk and creative thrust so necessary to its survival.

At the company's helm was the complementary management team of Chairman and CEO Raymond Plank and President and Chief Operating Officer Steve Farris. According to Plank, "*'Hustle,' the precursor to today's culturally defining 'sense of urgency,' most accurately described the competitive environment.*"

With MW and subsequent smaller acquisitions having fed an aggressive and successful domestic drilling program for the preceding three years, the inventory of attractive development properties needed replenishing. "Acquire and exploit" needed to acquire.

With rising production and cash flow, capital available for foreign expansion was increasing, even though the long-term bet on international growth was failing to yield meaningful impact on the bottom line. Australia grew organically from the 1993 acquisition of producing properties and the strategically important Varanus Island hub from Hadson. Egypt and China, with discoveries but no reserves, were in search of a next step. "International expansion" needed to expand.

Persistence paid off as domestic and international strategies for growth hit pay dirt with large transactions that defined the year: a $567 million domestic acquisition from Texaco and a merger with DeKalb Energy Company, marking Apache's return to Canada after a 25-year absence.

The Texaco transaction replenished the chest of drilling and exploitation projects and enhanced Apache's reputation as an independent that could benefit from transactions with the majors as they rationalized domestic assets. The return to Canada emphasized Apache's belief that the natural gas market would become more North American than domestic, diversification in selected basins globally

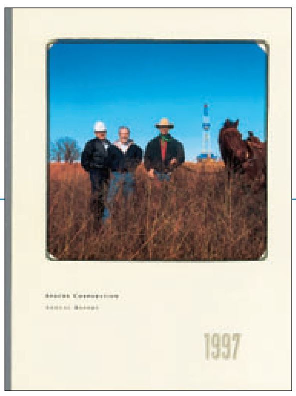
enhanced the potential for future growth, and a position in Canada's Western Sedimentary Basin represented the greatest opportunity to capitalize on anticipated North American natural gas supply shortages. With hindsight, Apache's move north of the border was a good four years ahead of the market.

By the end of the year, reserves and production hit record levels, yet earnings fell more than half to $20 million amidst soft price realizations. As asset values climbed 20 percent to $2.7 billion, long-term debt reached $1 billion and debt-to-cap flirted with 50 percent. Shareholder value remained flat with no meaningful long-term appreciation in the post-MW period.

Nevertheless, Apache continued to fill its quiver with arrows in the hunt for future opportunity. Financial discipline ensured the ability to act on that opportunity when it presented itself, yet volatile commodity pricing dampened potential as the cost of acquisitions in the United States and Canada exploded. Rather than chase growth for growth's sake, Apache put the reins on its acquisition activities. It was the beginning of a relatively inactive three-year period for the company in which all its skills — financial, operational and human — were to be put to the test.

Year-end 1995: Share Price $12.34* Earnings $20.2 million

*All Year-end Share Prices from 1995 through 2003 have been adjusted for subsequent stock dividends and a two-for-one stock split.



1996 — 1998 A Pause in the Action

It is one of the contradictions of Apache's culture that this three-year interval seemed like a period of calm. There was an abundance of critical mass. Equivalent reserves passed the 600-million-barrel threshold and equivalent daily production reached almost 64,000 barrels. Both were records. Earnings, never before higher than $47 million, twice exceeded $100 million. The number of gross and net wells drilled reached new highs. International expansion proceeded at a considered and deliberate pace in Australia, Canada and Egypt. The company grew and, despite the not insignificant pressure of soft commodity prices in an environment already stagnant, stored considerable strength for the future.

Why the perceived lull? Apache focused on the integration of DeKalb and Texaco assets and growth was more through exploitation than through acquisition. Exploitation is tails to acquire's heads. Acquire gets the press and reserves; exploitation gets the production and cash flow.

Apache's culture suggests that if there's no large acquisition in the works, nothing's happening. This is a relatively recent phenomenon. The exploitation of the Oxy acquisition, once it began, sparked the company's growth, giving it the size and ability to successfully close on MW five years later. But the intervening period wasn't perceived as a lull because the culture was dealing simultaneously with corporate restructuring, headquarters relocation and issues of simple survival. Over time, MW and its exploitation invigorated the company, underwrote Australian expansion, catalyzed the return to Canada, and provided the balance sheet that allowed the Texaco acquisition to happen. Yet there was no perceived lull between MW and Texaco as the culture again was assimilating a headquarters move, its second in five years.

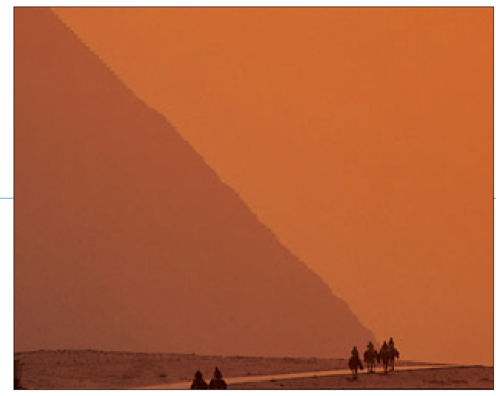
The post-Texaco/DeKalb period was different. There was no disruptive event waiting to capture the culture's otherwise pent-up energy. Headquarters was firmly settled in Houston and the corporate restructuring begun nearly 10 years earlier was largely complete. Although commodity prices were anything but strong and shareholder value was anything but dynamic, the company continued to grow. Simple survival had long since ceased to be a day-to-day issue.

These were good years, and they prepared Apache for what was to follow. The domestic regions were strong and profitable performers, funding the company's plans for international growth and diversification. With record production and oil and natural gas prices displaying a modest, albeit short, rally, earnings crossed the $100 million mark, first at $121 million in 1996 and then again at $155 million in 1997.

Operationally and strategically, news came from Egypt of what may well have been the most important event of the period: Apache merged with The Phoenix Resource Companies, elevating Egypt to a core area and positioning the company for the remarkable Egyptian successes that ultimately would follow.

Apache entered Egypt in 1994, convinced that the country's multiple producing basins, largely under-explored, offered the potential for large reserve additions at lower finding costs than those realized domestically. Furthermore, Egypt provided an acreage position ("running room") and the potential for market growth consistent with Apache's evolving international strategy and risk tolerance.

Many of the majors had dabbled in Egypt; most felt it was only a sideshow, offering limited reserves often long distances apart. Some broke their picks in the Western Desert and moved on to other opportunities. Apache saw greater potential. In fact, the core of Apache's international strategy was to find places where it could be a significant player without having to compete head-to-head against the majors. While this might mean no exposure to billion-barrel opportunities, it also meant no exposure to areas of intolerably high political risk.



Through the Phoenix merger, Apache brought hustle to its Egyptian operations. In its first year of production, Egypt produced two-thirds of international's total of 4.7 MMboe. The company ran five rigs, trucked up to 12,000 barrels of oil per day to market, completed construction of a 30-mile oil pipeline, acquired a 40 percent interest in the Western Desert's Khalda Concession, signed a $1.2 billion long-term gas contract, and ramped up net daily production to 14,400 barrels of oil. The company's 1996 Egyptian activities were emblematic of Apache at its finest aggressive and disciplined self.

Apache was following a well-established game plan. Ever since the Dow transaction in 1982, the Occidental transaction in 1986, and the MW transaction in 1991, the company had spent the intervening years streamlining its balance sheet and getting its financial house in order for the next opportunity, whatever and wherever it might be. The post-Texaco/DeKalb era was no different.

Moody's, Duff & Phelps (now Fitch) and Standard & Poor's upgraded Apache's long-term debt, citing among other things the company's reserve growth through drilling, increased earnings and cash flow, disciplined capital expenditures, gradually declining debt-to-equity ratio and successful international expansion. Capitalizing on the upgrades and attendant lower interest rates, the company issued $430 million of debt, $150 million of which had a 100-year term. The first oil and gas independent ever to successfully place "century bonds," Apache once again was following the road less traveled.

Consistent with its foreign growth and changing banking needs, Apache created a $1 billion global credit facility that not only further reduced overall borrowing costs but also provided a more efficient tax structure for international borrowings.

Apache was doing precisely what it needed to be doing when the pace was dictated by something other than a large acquisition and when the activity, of necessity, was turned inward rather than outward. That was, and is, the nature of a period of integration and exploitation. Lacking a transforming external event, Apache found time for introspection, seeking to refine its mission, define its core values, recharge itself and its employees and prepare for the opportunities and challenges that would inevitably follow. It was a period of reaffirmation of culture. It was not the first time Apache had gone through such a process.

Culture Defined

In its early years, Apache worked very hard at being the best at what it did without dwelling on how to define that undertaking. Pick an annual report from any of the first dozen and you'll generally find something no more complicated than a simple statement of what Apache is: an oil company in the customary sense; an investment management company; an operating and management company; and a diversified corporation. All were committed to service to customers, employee and company growth, realization for shareholders and building capital.

On the cusp of diversification in the late 1950s, Raymond Plank iterated a statement of purpose that provided a glimmer of the future Apache. It was at once candid, subjective and remarkably accurate with respect to everything that would follow: "*While Apache may sometimes appear to be going in several directions at once, we believe you can easily discern that its true course is in a single direction — the best possible one of all. That direction is up.*"

Not until 1968, however, was there a tangible hint of the cultural dimension which today we take for granted. It surfaced in response to times that were, at the very least, challenging. Broad-based diversification was still pursued. The noteworthy Fagerness discovery notwithstanding, oil and gas had yet to demonstrate any long-term growth potential and only six percent of the company's revenue came from the energy sector. Oil and gas personnel were restive in the face of what many perceived to be a diminished role. Listing on the New York Stock Exchange, and its associated credibility, were a year away. And the important innovations in oil and gas investments for which the company would ultimately be recognized were still some years in the future. It was one of those periods that begged for a steady hand at the helm and a clarification of purpose and direction.

The 1968 annual report attempted to define the philosophy of a company that truly was racing in many directions at once. The effort was noteworthy for its future vision. It was a statement more of an aspiration than an accomplishment and more of preparation for opportunity than reflection on achievement. Evidence of the blood in Apache's veins, it underscored the importance of the individual and the intangibles that forge a company beyond what is reflected on the balance sheet. It read, in part:

"Apache Corporation is a company of individuals devoted to rapid growth through innovative risk for the purpose of building a responsible, increasingly profitable, and enduring enterprise as a creative component in a democratic society.

"Individuals ... compatibly fulfilling Apache's objectives: The enhancement of personal confidence and self-realization through the pursuit of excellence with persons like-minded in their commitment.

"Innovative Risk ... the creative thrust achieved through challenging one's own and company-traditional assumptions ...

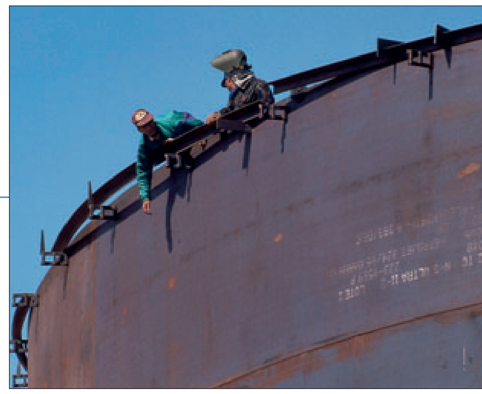
"Responsible ... to the various publics served ...

"Increasingly profitable ... profits per share compounding at an annual rate ...

"Enduring business enterprise ... providing continuity of service to customers and opportunity to shareholders and employees ...

"Creative component in a democratic society ... it is Apache's purpose to assist to improve our human environment through creative involvement ..."

While perhaps not obvious, and certainly not truly recognized without the benefit of hindsight, the greatest challenge Apache faced at the time was its helter-skelter approach to building an enduring business enterprise. "*The introspection helped us recognize opportunity,*" said Plank. "*It also reminded us why we went into business in the first place: to build an oil and gas company.*"



Three years later, the importance of oil and gas to Apache's future was loudly declared with the creation of Apexco. Two years after that, and based on the strategic recognition that the 1973 oil embargo had breathed new life into the energy business, Apache determined that its oil and gas activities were to be pre-eminent and that the time to begin shedding itself of its non-oil-and-gas assets had arrived. Once again, Plank clearly stated the case: "*We have entered a period of accelerated change and reordering. But, also, a period of new opportunities for those prepared to act upon them. Apache is diverse and strong; our leadership is seasoned, flexible and dispersed. The creativity of the entrepreneurially managed businesses that characterize Apache is supported and tempered by the perspective and discipline of a carefully selected management and board of directors. So, in a sense, we have spent nearly 20 years preparing ourselves for the opportunities which are emerging in this reordering.*" The earlier efforts to define culture and self-actualize set the stage for everything that would follow.

It is perhaps one of those historical curiosities that it took almost 20 years for Apache to conclude that its long-term future lay in oil and gas and another 20 years to reach the point of truly being able to capitalize on that conclusion.

In many respects, decades three and four were the most tumultuous of Apache's five. But Apache's culture, and its understanding of that culture, produced individuals who thrived on the challenge and, thereby, ensured survival. Hindsight would suggest that Apache was lucky. Reality would indicate it created its own luck. It witnessed the wisdom of empowering its employees to act swiftly and decisively in the face of opportunity. "*It has been Apache's experience,*" said Plank, "*that uncertainty resulting from change brings opportunity. The real challenge is to be ready for it.*"

The Capacity of the Individual

Whatever the historical view of the three years immediately following the Texaco and DeKalb acquisitions, Apache literally and figuratively caught its breath. Among other things, it used the time to re-examine culture and pragmatically set lofty goals to which the company would aspire. The outgrowth was a revisited mission statement and a declaration of core values, both of which were instructive to the degree they reflected Apache's structural evolution and enduring reliance on the individual. The heart of the mission statement, much like the effort undertaken in 1968, was more an expression of what was desired than a statement of accomplished fact.

"Our mission is to build a dynamic, global exploration and production company to provide oil and natural gas for the purpose of advancing the quality of human lives."

Developing a strong sense of collective mission, employees were encouraged to identify a short list of Apache's core values. "*All of us know the words that mark Apache's culture,*" said John Duncan, the Human Resources director who led the core-values discussion. "*Grow, succeed, innovate — and do it faster than the guys down the street. But without a shared set of values, growth, success and innovation don't stand a chance.*"

Companywide meetings yielded far-ranging discussions of the morals, ethics and ideals that should guide a global enterprise. Many values were considered and five made the cut as "core." Two have become defining:

Foster an entrepreneurial spirit by expecting and rewarding innovation and creativity;

Drive to succeed with a sense of urgency.

By the end of 1998, Apache's sense of itself and its employees' understanding of their respective roles were clearly defined. And both were empowered.

Then 1998 results were announced. Reserves of 613 MMboe and daily production of 174 Mboe demonstrated impressive growth. International reserves had grown to represent nearly half the company. The United States, thanks to strong production, was still the cash cow. Yet disappointing financial results, driven by oil and gas prices again near cyclical lows, yielded a reserve write-down and a financial loss after two years of record income. "Unacceptable" and "unpalatable" were the printable responses.

No one talked about a lull but everyone knew that the company had to make something happen. The atmosphere was similar to that of a locker room before the game. There was nothing left to prepare and no more inspiration to impart. It was time to take the field.

Year-end 1998: Share Price $10.87 Earnings ($131.4 million)

1999

Through the first quarter of 1999, commodity prices continued their slide. Four years had passed since the last large acquisition. The atmosphere was charged. "*Our acquisition team was ready,*" said Farris. They had reviewed and vetted countless opportunities in the past three years, only to see the larger ones collapse under the weight of the sellers' aggressive pricing scenarios. "*We needed to get a deal, a big deal, and we needed to bring it home.*"

And then the planets aligned.

In the price slide hid opportunity. Contrarian when they needed to be, Plank, Farris and Apache's senior-management group felt long-term prices could hardly fall lower than the 1998 averages of $2.16 per Mcf and $12.66 per barrel. They made sure that the acquisition-and-divestiture team had bench strength, that Finance and Treasury had Wall Street, the banks and the balance sheet ready, and that all had their seatbelts on. A ride that is yet to end was about to begin.

A hint of what was to happen appeared with a tactical Gulf-of-Mexico acquisition in February of 10 MMboe for just under $68 million. Half of it was financed with pension-fund capital structured as a net profits interest, leaving Apache's primary lines of credit available for something, anything, larger.

The lull officially ended when the team concluded intense negotiations with Shell and in April announced the $746 million acquisition of 123 MMboe, again in the Gulf. The transaction, Apache's largest up to that time, propelled the company into the top ranks of producers and leaseholders on the Outer Continental Shelf and cemented its reputation as an independent that could perform in large transactions with the majors.

That Apache was able to complete the transaction with Shell was not simply a case of willing buyer and willing seller coming together by chance. Apache had cultivated a relationship with Shell over the preceding years, eager to present itself as a capable buyer of properties when and if Shell wished to sell them.

"*As we would use Gulf production to help finance our international efforts,*" said Plank, "*we learned that Shell planned to sell several older, shallow-water assets in order to finance its deepwater exploration and development.*"

Meeting with their counterparts in The Hague in late 1998, Plank and Farris balked at the idea of participating in the auction Shell desired, offering instead a rapid close in return for a fair price. Without any guarantees, Apache went to work on the financing. What appeared to be a lightning-fast transaction when it was announced was actually the result of several months of very intense work. And, in Shell's eyes, it established Apache as a company with which Shell could do business.

That Apache had latched onto a matchless opportunity soon became evident. The company planned to finance the acquisition with an equity offering, flying in the face of conventional wisdom that said Wall Street, responding negatively to most oil and gas deals, would send share prices plummeting. Yet the market's response — not only to the fundamentals of the acquisition but also to the perception that commodity prices had reached the bottom of the cycle — was overwhelmingly positive, and Apache completed a $690 million offering, the largest in its history.

June brought another tactical transaction: 17 MMboe in Australia for $84 million. Then, just when the market was beginning to think Apache would bring down the curtain on a most active and successful year, the company announced a second Shell deal, this time for 87 MMboe in Canada at a cost of $518 million. Apache's Canadian subsidiary doubled in size just ahead of the onslaught of U.S. independents who would bid the purchase prices of Canadian assets to unprecedented levels.

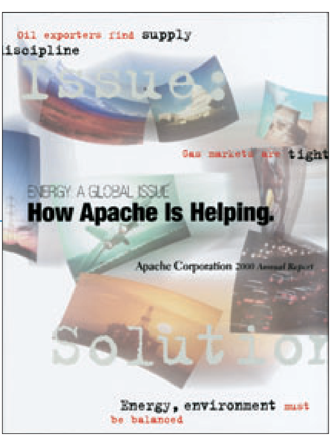
By the time the year ended, Apache had spent $1.4 billion to acquire proved reserves of 246 MMboe at an average cost of $5.83 per barrel. On the basis of reserves, acquisitions alone grew the company by 40 percent. And the exploiters didn't simply sit back and watch the acquirers. They added new reserves of 46 MMboe and grew production 17 percent to 74,600 barrels per day. With average oil and gas prices rising 46 and 13 percent, respectively, sales set a record at $1.14 billion, a 51 percent increase from 1998. Net income, too, reached a new high near $200 million. The loss of $131 million in 1998 was a memory.

"*It was gratifying to work alongside talented individuals capturing opportunity as if it might never occur again,*" said Plank. "*That we have been able to grow the company and add shareholder value is attributable entirely to capable, creative and motivated people. Apache is lucky to have them.*"

He then challenged those capable, creative and motivated people:

"What are you going to do for an encore?"

Year-end 1999: Share Price $15.99 Earnings $186.4 million



2000

If the idea of a sense of urgency passed its first test in 1999, it established itself as the Apache way in 2000. The year will be noted for many things, among them that Apache built upon the foundation constructed in 1999 by growing another 30 percent through acquisition. The 254 MMboe acquired that year was just short of the entire company's reserves at year-end 1994. The exploitation of properties previously acquired added another 115 MMboe, more than the company had on its books at any time prior to 1991.

With hindsight, and with earnings more than tripling to almost $700 million from the previous year's record, it will also be remembered as the year that pricing began the sustained run (albeit with short-term anomalies) that has held to this day. Why? Because supply and demand, out of balance for the better part of 15 years, no longer were. Strengthening prices did not occur in a vacuum, however, and energy, whether in the world market for oil or the North American market for natural gas, was on the cusp of becoming a highly visible economic and political issue.

With its healthy balance sheet and high credit ratings, Apache could make great strides in almost any price environment. For many companies that levered up in the 1990s, however, pricing trends through the decade coupled with only the beginnings of a recovery left them unable to service their debt from cash flow, forcing them to put producing properties on the market. As Vice President and CFO Roger Plank put it, "*Hear that sound? It's opportunity knocking.*"

The stabilizing effect of the previous year's equity offering on the balance sheet positioned Apache marvelously well for a string of transactions when its competitors were otherwise sidelined with too much debt. In many respects, Apache had the acquisition arena to itself.

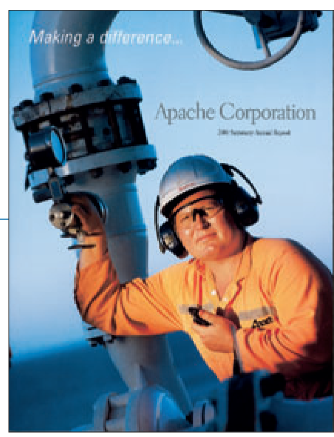
The acquisitions section of the company's 2000 Form 10-K has four consecutive paragraphs that begin, "Apache completed the acquisition of producing properties in . . ." The first two, from Repsol and Collins & Ware, replenished onshore inventories while the third, from Occidental, added to Apache's already sizable Gulf of Mexico position. Strategically, all three increased the ability of Apache's domestic regions to fund the ongoing international effort. By year-end, and with the very specific goal of capturing natural gas price increases that could prove to be fleeting, Apache's domestic drillers added 368 new wells, more than triple the previous year's total. It was a clear demonstration that the "acquire" side of "acquire and exploit" had no monopoly on a sense of urgency.

The fourth acquisition, from Phillips, demonstrated that Apache had confidence in its aggressive, north-of-the-border exploration and development program.

Date	*Location*	*Seller*	*Price*	*Reserves*	*Cost/Boe*
January 24	Mid-Continent	Repsol	$119 MM	29 MMboe	$4.14
June 30	Texas	Collins & Ware	$321 MM	84 MMboe	$3.83
August 17	Gulf of Mexico	Occidental	$321 MM	53 MMboe	$6.05
December 29	Canada	Phillips	$490 MM	70 MMboe	$7.00
Miscellaneous			$104 MM	18 MMboe	$5.68
Total			$1,355 MM	254 MMboe	$5.33

Apache's share price (adjusted parenthetically for subsequent stock dividends and a 2004 stock split) reflected the market's price volatility and traded between $32 ($13.85) and $74 ($32.03). When near $60 ($25.97), Apache and its board of directors adopted a share price appreciation plan that challenged employees to drive the company's growth to previously unattained levels before the end of 2004. The plan provided for the issuance of stock to most full-time employees if share-price goals of $100 ($43.29), $120 ($51.95) and $180 ($77.92) were achieved. At $60 ($25.97), the value of all shares outstanding was near $7.4 billion, a threshold that had taken Apache 46 years to reach. Employees were given until the end of 2004 to drive that value an additional $6 billion or more.

Year-end 2000: Share Price $30.33 Earnings $693.1 million



2001

If nothing else, 2001 provided ample evidence that a talented company with a strategy and a plan to implement it can weather most any storm that the market may throw its way.

In their annual letter to shareholders, Raymond Plank and Steve Farris put the year in perspective:

"Though overshadowed by the events of September 11, 2001 was marked by turmoil in the economy, financial markets and the energy industry. In January, natural gas prices neared $10 per Mcf, only to fall below $2 per Mcf in October. This price volatility is excessive, unwarranted and beyond acceptable parameters of supply and demand imbalances.

"The year ended with the spectacular — yet overdue — collapse of Enron Corp., an event that exposed tremendous regulatory, accounting, legal and ethical failures. The debacle has shaken confidence in the management of American corporations and cast doubt on the trustworthiness of financial reporting."

Yet, through it all, Apache thrived by pushing revenue, reserves, production and earnings to record levels. And, external forces notwithstanding, Apache kept challenging itself.

For the third year in a row, acquisitions drove growth. "*The big news,*" said Farris, "*were two strategically significant acquisitions we completed in Egypt.*"

Ever since the 1996 merger with Phoenix in which the company acquired a 40 percent interest in the prolific and profitable Khalda Concession, Apache felt that its growth in Egypt would be a function of growth at Khalda. Operated by Repsol YPF, the Spanish national oil company, Khalda drilling in the intervening years had added new reserves at approximately the same pace annual production was depleting them. Apache, confident that it could improve returns through a combination of stepped-up exploitation and reduced operating costs, proposed a buyout of Repsol's 50 percent interest.

The proposal was not a shot in the dark. Apache knew that Repsol's debt, following the acquisition of Argentina's YPF, required a degree of relief.

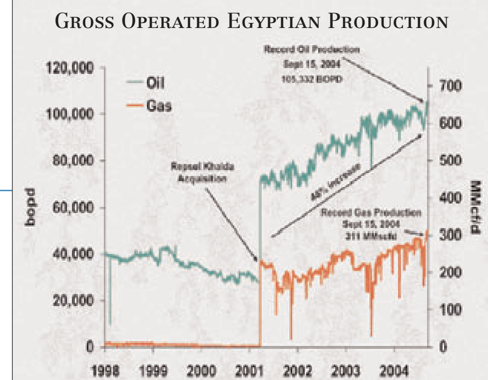
In March, Apache announced the purchase of Repsol's 66 MMboe for $447 million. Before yearend, the 10 percent previously owned by Novus was also in the fold. Apache operated and held a 100 percent contractor interest in the concession that two years hence would yield the largest discovery in Apache's history, proof that good things come to companies that make things happen. When Steve Farris said, "*The acquisition changes the cadence for Apache in the Western Desert,*" he had no idea how magnificent understatement could be.

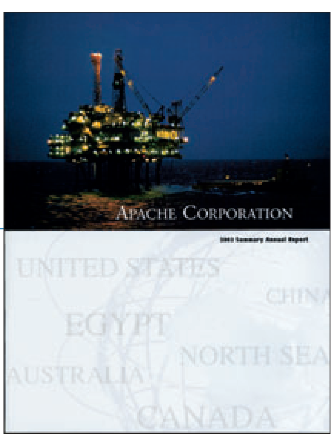
Simultaneously, Apache announced another Canadian acquisition, this one born of the ever-evolving relationship with Shell. Fletcher Challenge Energy, a New Zealand-based company, had previously indicated its intent to liquidate its holdings. Shell, interested in Fletcher's New Zealand and Brunei assets, and fully cognizant of Apache's desire to expand its Canadian position, invited the company to work jointly in the transaction. Taking Shell up on its offer, Apache acquired 121 MMboe for $677 million. In three short years, Canada had grown five-fold and represented on the basis of reserves nearly 30 percent of the company.

In addition to the Canadian properties, Apache acquired Fletcher's small interest in Argentina. Though not a core-area acquisition, Apache had gained another toehold for potential future expansion.

With the tremendous inventory of properties acquired since the first-half of 1999, Apache's drilling teams were kids in a candy shop. Their contribution in 2001 was impressive: They added 193 MMboe in new reserves. It was the largest, non-acquisition, "growth-through-the-drill-bit" increase in the company's history.

Year-End 2001: Share Price $21.59 Earnings $703.8 million





2002

The picture that Apache had painted since the end of 1998 was impressive. In three hectic years, the acquirers and exploiters had more than doubled the size of the company, taking it from 613 MMboe to just short of 1.3 billion barrels equivalent. And the hypothesis of diversifying risk and growing the company incrementally through international core areas was passing the test.

CORE-AREA RESERVE GROWTH, 1998-2001:

Country	*Reserves (MMboe) 12/31/1998*	*Reserves (MMboe) 12/31/2001*	*Growth*
United States	311	601	93%
Canada	67	354	428%
Egypt	88	157	78%
Australia	133	154	16%
Non-Core	14	1	(93%)
Total	613	1,267	107%

The year, when compared to its bookends, was an interlude between transforming events. Earnings softened from the records of the previous two years, yet still reached the third-highest level in the company's history. Average prices, extremely volatile in the short-term, took the one step back that now looks like the prelude to several steps forward. Reserves, growing at double-digit rates each year since the end of the lull, crept forward only four percent. Acquired reserves, surpassing more than 200 MMboe annually for three years running, totaled less than 50 MMboe. And new reserves added through drilling were down 40 percent from the preceding year's record high. While it may have appeared the market was applying resistance to the Apache model, there was strategic significance to the company's conduct of the year's activities.

"*We indicated late in 2001 that Apache would reduce its spending on drilling and acquisitions in favor of paying down debt and maintaining financial flexibility,*" said Farris. "*This was done not so much because the balance sheet needed attention, but rather in response to economic uncertainty: Drilling costs were rising; commodity prices remained highly volatile; the acquisition market was overheating; and the merchant-traders were imploding. We'd had a remarkable run. It was time to stand back, take a breath and assess.*"

Standing back at Apache is relative. Even with the reduced capital budget, the company pushed itself by drilling its first-ever deepwater wells to explore the West Mediterranean Concession offshore Egypt's Nile Delta. By the time the five-well exploration program was over, Apache and its partners had satisfied themselves that commercial quantities of reserves, estimated as high as three trillion cubic feet of natural gas, could be developed. Further exploration was deferred, pending the finalization of a gas contract with the Egyptian government under which the partners could deliver some 500 million cubic feet of natural gas per day to meet the rapidly growing demand of the Egyptian market.

Australia's year affirmed technological achievement. The history of drilling around Varanus Island had long established the gas-prone nature of the basin and underscored the relative difficulty of finding oil. In a market unable to readily absorb more gas, the challenge to Apache's geophysicists was clear: How could they refine the processing of seismic data, normally used to identify natural gas reservoirs, in such a way as to make it a reliable indicator of potential oil-bearing targets?

Apache's Perth staff began to focus on the problem in the late 1990s. By 2001, they had discovered that the selective use of certain bits of seismic information, rather than the whole suite of data, painted reservoir pictures Eve Howell, then exploration manager, described as "*a little bit different.*" With the trial and error of new wells, some successful and some not, they established a correlation between seismically identified reservoir quality and the presence of oil, allowing them to map what they believed to be oil-bearing seismic events.

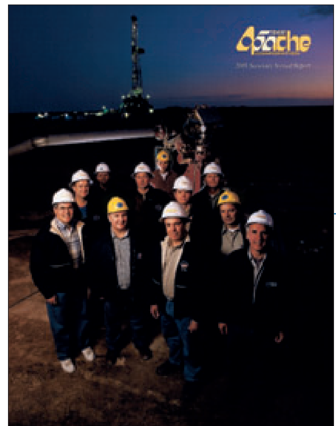
And what happened in 2002? Australia drilled seven Flag sandstone oil discoveries that raised the region's daily oil production to an all-time high of nearly 50,000 barrels.

Canada, assimilating the three acquisitions from Shell, Phillips and Fletcher Challenge, also set a daily production record, reaching nearly 90 MBoe.

And the United States, not to be outdone, completed the December acquisition of producing properties in south Louisiana with reserves of 178 billion cubic feet of natural gas equivalent for $206 million.

At year-end, several motivated individuals missed holiday parties and the midnight oil burned brightly. Not always correct but ever so efficient, the grapevine carried new acquisition rumors. But what was left to acquire? The domestic regions were battling indigestion from the Collins & Ware, Repsol, Oxy, Shell and Louisiana transactions. Canada had pushed itself away from the table after feasting on Shell, Phillips and Fletcher Challenge. Egypt had swallowed the Repsol interests and Australia, already controlling its destiny on the Northwest Shelf, had a steady diet of oil discoveries to develop.

Year-End 2002: Share Price $27.14 Earnings $543.5 million



2003

On January 13, Apache announced its largest transaction ever, a $1.3 billion acquisition from BP for producing properties in the United Kingdom North Sea and the Gulf of Mexico. For approximately half the purchase price, Apache acquired the Forties Field offshore Scotland, adding nearly 150 MMboe and its sixth core area.

"*We had considered North Sea expansion for a number of years,*" said Kregg Olson, vice president of corporate reservoir engineering. "*Forties fit our international, core-area business model and offered excellent opportunities for improved returns. With the application of certain tax efficiencies available to UK operators, Forties should write another very positive chapter in the Apache story.*"

The acquisition sent ripples through the industry. Forties, discovered by BP in 1970, was the largest discovery ever in the UK portion of the North Sea. A BP legacy property christened by Queen Elizabeth II when it commenced production in 1975, it had produced 2.5 billion barrels of oil yet still ranked eighth in production and reserves.

The Forties acquisition again demonstrated the value of the Apache model. Several transactions with Shell in the preceding four years happened largely because of personal relationships developed years earlier. By the time the assets came to market for auction, Apache's proven ability to perform at a fair and negotiated price outweighed the sellers' desire to be drawn into a potentially time-consuming bidding process.

"*Prior to the Forties transaction, I introduced the Apache team to several of my former colleagues at BP,*" said Apache Director Chuck Pitman. "*When BP decided in late 2002 to sell Forties on a most aggressive timeline, the desire to go to auction never had a chance against personal relationships and Apache's track record.*"

Almost lost in the klieg lights on Forties, half the BP transaction was for producing properties in the Gulf of Mexico. By the time that and a smaller $200 million purchase from Shell closed, Apache had become the largest held-by-production leaseholder on the Outer Continental Shelf. (By way of historical footnote, the sale marked Shell's exit from the Shelf but for a few properties that constitute part of its delivery system from the deep water. The company that had introduced Apache to the Shelf 22 years earlier had left.)

The excitement didn't stop there. The acquirers had stolen many headlines since 1999 and the exploiters, all of whom could be forgiven for thinking they were taken for granted, did everything that was expected of them, and more, over the same period. In the din of almost five years of unprecedented acquisition and exploitation activity, the explorers were having a hard time making their voices heard.

That isn't to say they weren't doing their jobs. Properties acquired in the Shell Canada purchase yielded Ladyfern, that nation's largest natural gas discovery in 20 years. Australia made tremendous progress identifying oil reservoirs and Egypt, prior to the West Mediterranean success, had produced a regular string of profitable discoveries in the Western Desert.

Perhaps the last piece to fall into place in the equation of Apache's operational success in the current era, exploration took giant steps forward in 2003. In Australia, the John Brookes field yielded reserve estimates of 800 billion cubic feet of natural gas. And each of three discoveries in the Exmouth Basin, as yet undeveloped, have estimated recoverable reserves of at least 40 MMboe.

The big story, however, was in Egypt where "*the largest onshore discovery in the history of the company was drilled at Qasr in the Western Desert's Khalda Offset Concession,*" said Rod Eichler, executive vice president and general manager in Egypt. "*Subsequent appraisal confirmed the presence of a gas-and-condensate reservoir of up to 700 feet in thickness. Estimated recoverable reserves approach three trillion cubic feet of gas and 20 million to 70 million barrels of condensate. It is a world-class discovery.*"

Apache's decade-long quest in Egypt, now validated, had reached a pinnacle, thrusting the Western Desert to a level of prominence far beyond the minor petroleum province so many deemed it to be. "*Qasr's geology is characterized by highly productive sands in hydrocarbon columns that rival or exceed the height of the Washington Monument,*" said Eichler. "*And with a field roughly the size of Manhattan Island, we have a lot of running room for exploration and development. Qasr will keep us busy for years.*"

And then there was news from China. Some called it icing on the cake, others poetry. At almost the same time the explorers were celebrating Qasr, the Bohai Bay producers brought Apache's 1994 discovery on line at an initial rate of 6,000 barrels per day. It had been nearly a 10-year struggle against government red tape and a partner's bankruptcy. Many likened the experience to dragging a battleship across the desert. "*I'd be less than truthful if I told you we never wavered,*" said Farris. "*It's not Apache's style to take 10 years to do anything. But getting the job done is what we do, no matter what the challenge.*"

First production in China was emblematic. Apache was firing on all cylinders.

Year-End 2003: Share Price $40.55 Earnings $1.1billion

In the land of the pharaohs: an Apache drill in Egypt's Western Desert. Since Apache took over, production is up 39%.

Oil & Gas Operations

APACHE | Simply Gushing

"WE'VE NEVER BEEN INTERESTED IN QUICK HITS on the quarterly side," says Raymond Plank, Apache Corp.'s famously frank founder and chairman. "That's where you fall on your can."

Maybe he's just knocking wood: Last year the Houston-based exploration and production company was on track to net $1 billion on revenues of $4 billion, up 84% and 58%, respectively, over the previous year.

Apache created the windfall by continuing to work over Gulf of Mexico fields without pouring money into expensive deepwater technology, and by aggressively boosting production in Australia and Egypt. A decade in the Middle East taught Plank and G. Steven Farris, his chief executive, that they needed not only access to the fields but also control of operations (over half its production is outside the U.S.). Apache's benchmark is a 12% aftertax return on every well. In Egypt the company's state-owned partner Repsol was not operating the Western Desert's Khalda concession aggressively enough. Since Plank & Co. took over in 2001, production is up 39%. The company bought $1.5 billion worth of juicy prospects in the North Sea and the Gulf of Mexico from BP and Royal Dutch/Shell in 2003, upping its reserves to 1.5 billion barrels of oil equivalent.

The expansion hasn't crumpled the balance sheet. Apache's debt-to-capital ratio is a rock-bottom 28.5%. Nor has it hurt the stock: In the last 12 months the company's share price rose 39% to $78.

—Lynn J. Cook

Oil & Gas Operations	5-yr annualized total return (%)
Anadarko Petroleum	8.8
Apache	20.7
Burlington Resources	7.5
ChevronTexaco	0.7
ConocoPhillips	8.0
EOG Resources	21.4
ExxonMobil	5.8
FMC Technologies	-1.4[1]
Marathon Oil	3.3
Murphy Oil	26.2
Nabors Industries	21.0
Noble Energy	8.6
Royal Dutch Petroleum	0.7
Sunoco	11.2
Valero Energy	18.5
Western Gas Resources	38.3
World Fuel Services	31.4

2004

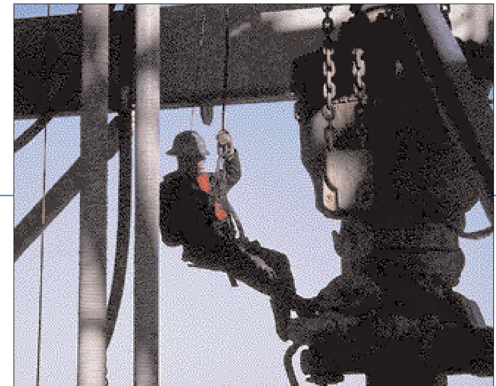
Established in 1954 with $250,000 of investor capital, Apache Corporation has grown to become one of the world's top independent oil and gas exploration and production companies, with $12.4 billion in assets. Apache's U.S. operations are focused in some of the nation's most important producing basins, including the Outer Continental Shelf of the Gulf of Mexico, the Anadarko Basin of Oklahoma, the Permian Basin of West Texas and New Mexico, the Texas-Louisiana Gulf Coast and East Texas. In Canada, Apache is active in British Columbia, Alberta, Saskatchewan and the Northwest Territories. The company also has operations in the Carnarvon Basin offshore Western Australia, Egypt's Western Desert and offshore in the Mediterranean, the United Kingdom sector of the North Sea, China and Argentina.

Apache Corporation 2003 Annual Report

What does one do for an encore to record reserves, production and earnings? "*The answer comprises two sides of the same coin,*" says Farris. "*Part of it lies in knowing how you achieved the milestone in the first place. The other lies in how you frame the challenge.*"

Consider for a moment the road the company has traveled. On page 16 of this history you read Apache's description of itself as contained in the company's 1982 annual report. Compare that to the most recent description above.

As much as this newer summary accurately depicts the growth and development to which the "new" Apache aspired in the late 1980s, it is doubtful predictions written then would accurately forecast the company Apache has become. Hindsight has a way of making Apache's history look like an orderly progression when, in reality, it is more often a matter of meeting day-to-day challenges with an adaptable plan, a firm understanding of the business, the resolve to survive and fight another day and the faith that many of the seeds planted today will bear fruit tomorrow. If there were to be an additional core value added to the list, it would be simply stated: Finding a way.



To wit: All but the most recent years of Apache's fifth decade have been characterized by the challenge of highly volatile commodity prices. In response, Apache has focused on managing through the pricing cycles, be it by the implementation of hedging tools to protect acquisition economics, the steady strengthening of the balance sheet and maintenance of financial flexibility through debt reduction, and the careful management of capital expenditures. Such financial discipline has reaped many benefits, from low debt-to-capitalization ratios to high credit ratings. In conjunction with the company's established reputation as a preferred purchaser of assets, the strong balance sheet has provided the ability to swiftly respond to opportunity: Witness the speed with which Apache pounced on the $1.3 billion BP acquisition in early 2003, thereby adding built-in reserve and production growth when the year was still young.

In the past two years, the environment has shifted. Average gas and oil prices have reached record levels, presenting an entirely different set of challenges. There's no sense of the normal cycle as prices have never before demonstrated such sustained and prolonged strength. Accordingly, the acquisition market has tightened as potential sellers have chosen near-term cash flow in favor of a debate with buyers over the long-term direction of prices. And buyers, quite naturally, have demonstrated reluctance to pay prices in the out years that are reflective of currently strong strip-price projections.

Even so, Apache found a way in the second quarter to negotiate with a major company a transaction that balances the normal emphasis on the economic acquisition of production and reserves with the bartering of assets to enhance the potential for future return.

On May 25, Apache and ExxonMobil announced a program designed to capitalize on the strengths and assets of both companies in order to optimize future exploration and development potential in both the Gulf of Mexico and Canada. In addition to the purchase by Apache of certain producing properties in the Permian Basin that bring with them a stable production profile, the transaction gave Apache exploratory

exposure in Canada. In return, Apache relinquished half of its deep rights on the Outer Continental Shelf for a period of five years. Referred to as "the deep shelf," it is an embryonic exploratory play requiring greater capital than Apache is presently willing to risk. By sharing the rights with ExxonMobil, Apache not only reduced its risk and exposure, it also increased the likelihood that such exploration will occur.

Closing on the deal early in the fourth quarter, John Christmann, Apache's vice president of business development, described it as "*a far-reaching, value-added transaction that demonstrates Apache's ability to plan for the future by adapting in a competitive environment.*"

The ExxonMobil transaction was not the only example of finding a way. Late in the third quarter, Apache announced that it had signed a definitive agreement to acquire all of Anadarko Petroleum's Gulf of Mexico Shelf assets for $537 million and the assumption of $99 million in liabilities. Prior to that, Morgan Stanley Capital Group agreed to pay Anadarko $775 million for an override on a portion of the lower-risk reserves. Through the three-party arrangement, Apache acquired control of property valued at over $1.3 billion for a fraction of the cost, booked its share of the acquired reserves at economic and competitive per-unit levels, retained all the potential upside on future exploration and development of the properties and further cemented its position as the largest held-by-production leaseholder on the Shelf.

Effective October 1, 2004, the transaction closed October 25.

Perhaps the best way to grasp Apache on the cusp of its golden anniversary is to listen to Tom Chambers. As the company's vice president of planning, he is blessed with an optimism born of always looking to the future. Notice the potential with which he framed 2004:

"We start 2004 riding on the strength of our balance sheet, the crest of high commodity prices coupled with strong production and the successful integration of the BP acquisition, Apache's largest ever. We have chosen to 'pour' a slightly more aggressive Plan than last year, but one that is achievable and flexible, based on our oil and gas price assumptions. Our projected free cash flow from a modest production increase and higher commodity prices is sufficient to fund our increased exploration and development program and still generate excess cash for future acquisitions, expanded drilling activity or debt reduction. Projected earnings are significant and, if the strip holds, will rival last year's record. Excess cash flow could bring debt down to levels below 25 percent of capitalization. The year holds a multitude of opportunities for us to build on our successes of last year, opportunities for which we are well positioned. The challenge is execution."

Conclusion

The history you hold in your hands went to press early in the fourth quarter of 2004. By definition, it is of limited perspective on the balance of Apache's 50th year and on the impact of the year's events. Some things, however, remain true, no matter when they are written.

After a half-century of growth in a volatile and constantly changing commodity business, there are countless lessons to be learned, not the least of which is that success is hard-earned and easily squandered. Challenges to growth and survival are a constant.

Entering its sixth decade, Apache has seen the founders' seed capital of $250,000 grow to exceed $16 billion and the initial shareholder population of 41 pass 181,000. The mantle worn by the handful of original Minneapolis employees has been passed to a global population of over 2,500. With that degree of success and growth, complacency is a constant challenge.

The battle against highly volatile and often inadequate commodity prices has abated, with current averages maintaining record levels sufficiently high to deliver satisfying shareholder returns. History says that the pricing environment, no matter how lofty or low, always finds a way to present challenge.

Larger and financially stronger than at any time in its history, Apache is well positioned to continue its mission of adding critical mass and building to last. As others battle higher finding costs on a dwindling inventory of properties, Apache has assembled a portfolio of six core areas with an attractive mix of exploration, development and exploitation opportunities.

Annual production now approximates the company's entire reserve base when it moved to Houston from Denver. Cash flow remains strong and is a testament to the company's unwavering focus on rate-of-return decision making.

The foundation of Apache's strategy has always been diversity of risk, be it geographic, geologic, political or of product mix. Added to that is an increasing focus on larger exploration opportunities outside the United States.

Apache today is one of the most profitable independent oil and gas companies. It has become so with a firm understanding of its past and a strong faith in its future.

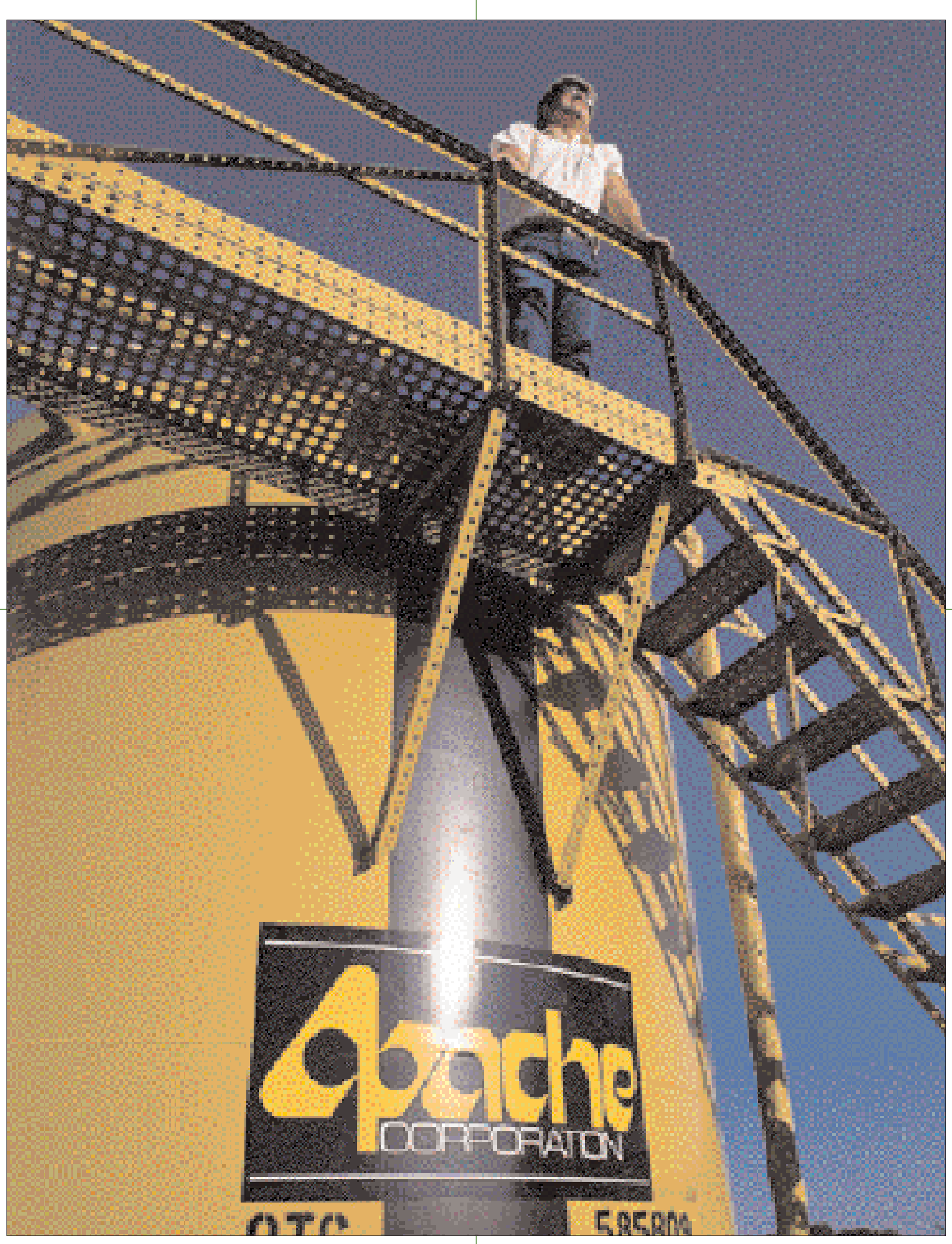
Approaching its 50th birthday on December 6, 2004, Apache is carried by a remarkably talented and motivated workforce. While so many are not identified in this history, all are major contributors to the company and its shareholders' success.

Over 1,900 members of that workforce earned shares of restricted stock when the first and second thresholds of the Share Price Appreciation Plan were achieved on April 28 and October 26, respectively. In four years, Apache and its employees doubled the company's share price, adding more than $9 billion in shareholder value.

People employed when Apache adopted the plan in 2000 earned shares equal to at least 100 percent of their salaries at that time. Employees hired subsequently earned prorated awards. More than 90 percent of the incentives are to be paid to non-executive employees.

"*Reaching this goal is a great achievement, both for Apache shareholders and our employees,*" said Steve Farris. "*Higher prices have certainly helped, but in the last four years Apache's reserves have doubled to 1.7 billion barrels of oil equivalent and production has increased 87 percent to approximately 460,000 barrels of oil equivalent per day. Our employees under this plan are happy and justifiably so. They've earned it.*"

Those employees' hard work, sometimes unacknowledged but at all times appreciated, directly contributed to the accomplishment of the goal. It is the Apache way.


apache
CORPORATION

50 DEFINING MOMENTS

Founding of Apache 1954
First Well 1955
First Full Year 1955
First SEC-Registered Programs 1956
Diversification 1959
Apache Realty Corporation 1959
Corporate Governance 1964
Fagerness No.1 1967
New York Stock Exchange Listing 1969
S&J Ranch 1970
Apexco 1971
Oil Embargo 1973
Program 1973-II 1973
Buchan Field, UK North Sea 1974
Divestiture 1977
North Block 1977
Pension-Fund Financing 1980
Apache Petroleum Company 1981
Shell Joint Venture 1981
Ucross Foundation 1981
Dow Acquisition 1982
Killing the Key Well 1983
Occidental Petroleum Acquisition 1986
Tax Reform 1986
Move to Denver 1987
APC Rollup 1988
Going International 1988
Acquire and Exploit 1991
MW Petroleum Acquisition 1991
Move to Houston 1992
Roberto Acquisition 1992
Core Areas 1993
Hadson Acquisition 1993
Hall Houston Acquisition 1994
Texaco Acquisition 1995
Dekalb Merger 1995
First $100 Million Year 1996
Phoenix Merger 1996
Mobil/Ampolex Acquisition 1997
S&P 500 1997
The Fund for Teachers 1998
Shell Gulf of Mexico Acquisition 1999
Canadian Expansion 1999
Repsol Acquisition 2001
West Mediterranean Discovery 2002
BP North Sea Acquisition 2003
Qasr Discovery 2003
Record Earnings, Production, Reserves 2003
Evolution of Culture 2003
Recognition 2004

APACHE OIL CORPORATION

ANNUAL REPORT

1955

631 MARQUETTE AVENUE
MINNEAPOLIS 2, MINNESOTA

1954 Founding of Apache

In an era when Apache's critical mass and staying power are assets to be aggressively defended, it is worth remembering that there was a time when it wasn't always so. The company's first corporate objective, to survive and be profitable after one year, seems far removed from building a company to last.

Raymond Plank and Truman Anderson

Apache Oil Corporation was founded on December 6, 1954, in Minneapolis, Minnesota, by Truman **A**nderson, Raymond **P**lank and Charles **A**rnao. An article in the *Minneapolis Tribune* that month said the company was involved in the business of "locating, producing and marketing oil and gas."

The three partners, fascinated by the investment and tax-shelter opportunities offered by drilling for oil and gas, challenged early employees to develop a name for their venture. Helen Johnson added "che" to APA and was awarded a $25 United States Savings Bond for her efforts.

The newborn Apache operated under principles of accountability, full disclosure and risk diversification. The three partners flipped a coin to see who would be the company's first president, with the understanding that the title would rotate and change hands annually. As fate would have it, Raymond Plank, the founder whose name would become synonymous with Apache and who was the company's Chairman on its 50th anniversary, won the initial toss.

Diversifying beyond oil and gas, Apache Oil Corporation became Apache Corporation on June 4, 1960. Eventually, there were as many as 58 non-oil-and-gas subsidiaries. Selling the last of them in 1987, the company returned to its roots. It retained, however, the younger and more widely recognized name.

1955 First Well

In 1955, Tulsa, Oklahoma, was considered the U.S. capital of the petroleum business. Many of Apache's early clients had oil and gas interests in the state. It seemed only logical that the company drill its first well there.

Apache's contacts recommended that the company seek opportunity in the Cushing field in and around the town of the same name located about midway between Tulsa and Oklahoma City. The field, discovered in 1912, was mature and had been abandoned by many of the companies that once operated there. Almost 40 years before Apache would refine its strategy of "acquiring and exploiting" mature properties left behind by the majors, the company saw opportunity in the application of new technologies that would recover the previously unrecoverable.

The first Cushing well came in at a whopping seven barrels per day, making it abundantly clear that no one in Minneapolis was on the road to easy and immediate wealth.

Learning something, Apache then drilled the Bradley Rafferty No. 1 well. Producing initially at a rate of more than 700 barrels per day, its sponsors in Minneapolis took note.

By the end of its first full year the company had production of 800 barrels per day from three fields in central Oklahoma, one in Nebraska and one in Kansas.

Apache Oil Corporation was officially on its way.

1955 First Full Year Ends Profitably

APACHE OIL CORPORATION
Balance Sheet
December 31, 1955

ASSETS			
CURRENT ASSETS			
Cash on hand and in banks		$ 28,059.32	
U.S. Treasury Bills, at cost		249,950.00	
Accounts and notes receivable		37,519.58	
Inventory of properties for resale		69,445.90	
Accrued oil runs		1,075.08	
Prepaid insurance		166.67	
Total Current Assets			$386,216.55
PROPERTY, PLANT AND EQUIPMENT, AT COST (NOTE 1)			37,241.83
ORGANIZATION EXPENSE			3,021.40
Total Assets			$426,479.78
LIABILITIES			
CURRENT LIABILITIES			
Accounts Payable		$ 20,373.56	
Payroll taxes payable		787.60	
Accrued salaries and wages		245.70	
Federal and State income taxes (Note 2)		2,571.17	
Total Current Liabilities			$ 23,978.03
STOCKHOLDERS' EQUITY			
Common stock $2.50 par value; authorized 240,000 shares; outstanding 180,000 shares	$450,000.00		
Less capital stock expense (Note 3)	60,033.50	389,966.50	
Earnings reinvested in the business, net income for year		12,535.25	402,501.75
Total Liabilities and Stockholders' Equity			$426,479.78

The accompanying notes are an integral part of this statement.

Raymond Plank would be the first to tell you that Apache sets aggressive annual performance objectives and, in the interest of incremental growth, sets many rather than just a few. And what was the first "aggressive" objective? "*I expected Apache to be profitable in the first year,*" he said.

Closing the books on 1955, Apache achieved the objective: It earned $12,535 on gross revenue of $190,000. Operated production averaged 800 barrels of oil per day. There were 23 employees, 173 shareholders and 180,000 shares of common stock outstanding. Apache's market value approximated $2.5 million.

Apache has had similar degrees of success with its objectives ever since. Today, the company produces 800 barrels of oil and earns $12,535 every three minutes; it records $190,000 in revenue every 24 minutes.

Earnings, on revenue of $4.2 billion, passed the $1 billion threshold for the first time in 2003. With oil and gas operations in seven countries on six continents, Apache employs more than 2,500 people. Over 180,000 investors, individuals and institutions alike, hold 325 million shares. And, at $50 per share, Apache's market value exceeds $16 billion.

1956 First SEC-Registered Programs

“If investing in oil is such a good deal, why aren’t you selling in the oil patch?” That was a familiar refrain in the upper Midwest when less-than-scrupulous promoters sold oil deals to those who were as financially wealthy as they were energy-investment ignorant. The conventional wisdom was simple: If the deal were good, it would have been grabbed by knowledgeable investors in the oil and gas producing states.

“If investing in oil is such a good deal, why aren’t you selling in the oil patch?”

As industry demand for new investment grew, Apache developed and capitalized on a strategy that marginalized the unscrupulous and expanded the legitimate investment pool beyond the oil-patch states: It developed an SEC-registered oil and gas investment vehicle structured to better protect the investor.

As both general and limited partner, Apache set out to accommodate investor needs, spread risk, bring operations in-house, and give itself an identity of interest alongside investors. Limited partnerships formed annually enabled more-efficient tax planning and reduced investor exposure; a drilling inventory covering several prospects rather than a few wells diversified risk while simultaneously eliminating the promoters’ ability to tout specific wells or prospects; in-house operations lowered costs and made Apache accountable for drilling results; side-by-side investment by senior management and board members enhanced financial oversight.

The principles that seemed entrepreneurial at the time became the industry norm and set the standard for what would become a long string of Apache innovations.

The SEC, well aware of historical investor dissatisfaction with the business, approved Apache's approach to creating oil and gas investment vehicles, making Apache's blind-pool drilling funds the first to be registered with that body. The principles that seemed entrepreneurial at the time became the industry norm and set the standard for what would become a long string of Apache innovations.

SEC approval, in and of itself, did not guarantee success. It merely provided the platform. That Apache's idea had validity was borne out by the company's and the idea's staying power: From 1956 though 1986, Apache formed as many as three or four partnerships per year, adapting their structure to the times but never tinkering with the underlying fundamentals.

The business of creating and managing partnerships defined for over 30 years how Apache earned its keep, serviced its investors, grew and evolved in the marketplace, established credibility and weathered the storms of a cyclical business to survive when most others didn't.

1959 Diversification

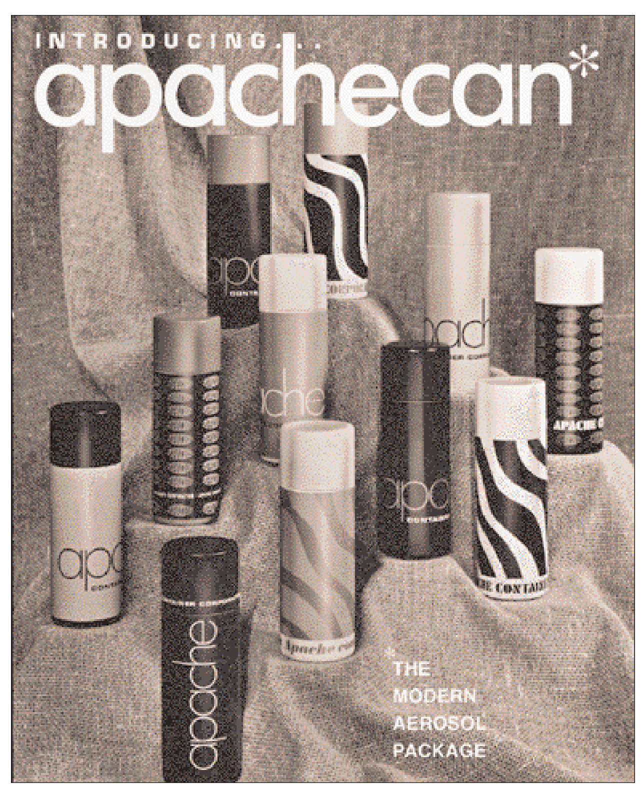
One of the most important strategic decisions ensuring Apache's survival in the oil and gas business was its diversification away from it.

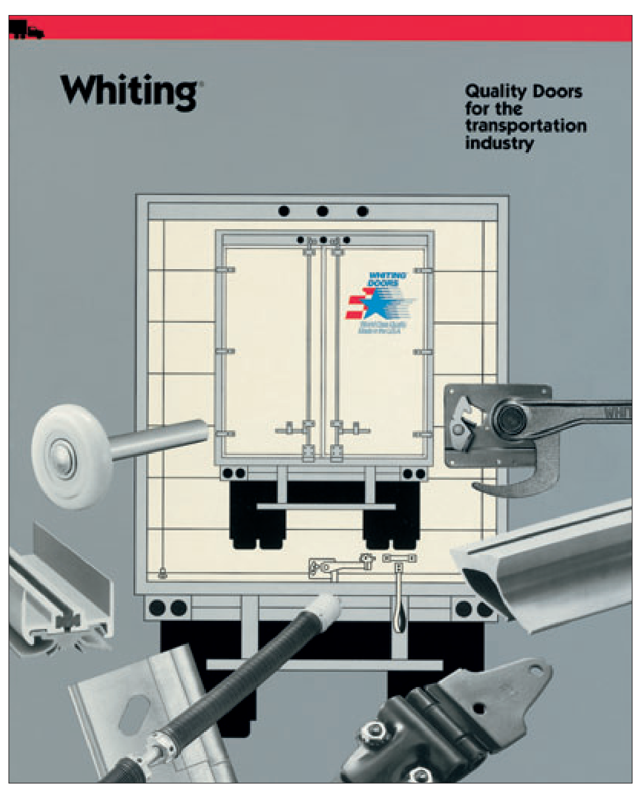
In 1956, Egypt closed the Suez Canal and choked off U.S. oil imports from the Middle East. In response, the domestic petroleum industry set production records, moving nine million barrels per day to refineries. When the canal reopened in 1957, oil imports spiraled upward and competed for space in storage facilities already strained at capacity.

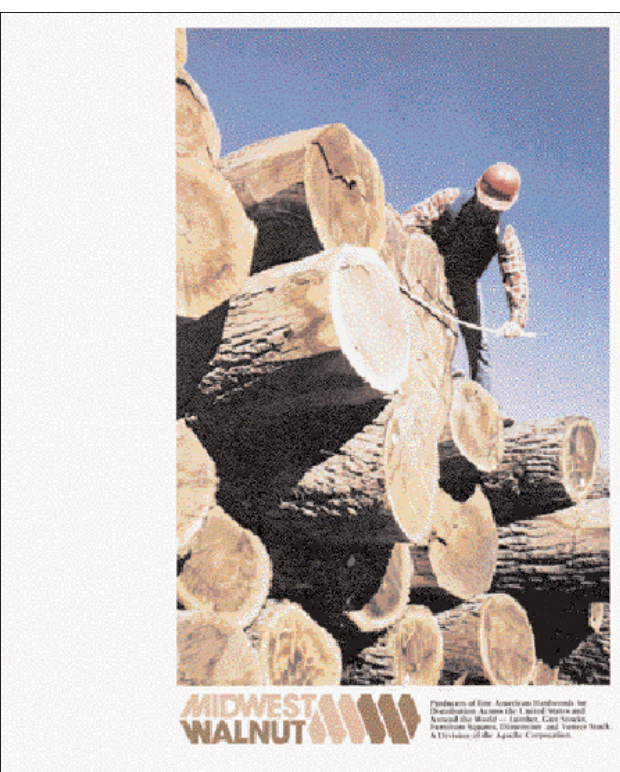
Recognizing what the *Oil and Gas Journal* called "excessive inventories," the major producing states put limits on their production. Apache, suffering a 90 percent reduction in its daily per-well allowable rate and facing the growth challenges of an oil and gas company in only its fifth year, recognized that government regulation of the industry could put it out of business. Always confident that oil and gas would someday yield long-term growth and profitability, Apache's founders set out to ensure the company's survival until that day arrived.

Never fully abandoning its underlying foundation in the business ("*We were an oil company in waiting,*" Raymond Plank was often heard to say), Apache diversified from the late 1950s to the early 1980s into real estate, agriculture, steel, plastics, telephones, utilities, cattle and dude ranching, aerosol cans, lumber and auto supplies, to mention but a few of the 58 businesses the company acquired. In 1960, recognizing its changing role in the marketplace and the evolving nature of its business, the company changed its name, figuratively and almost literally removing "Oil" from the equation.

Apache's diversification strategy was simple: Focus on small, non-public, entrepreneurial businesses that demonstrate high potential for growth in America's post-







World War II economy; retain the entrepreneurs and delegate authority to them; and use Apache common stock as the currency for the acquisitions, instilling a high identity of interest in management and ensuring their long-term focus on subsidiary growth. Corporate growth was sure to follow.

Fashioning itself as a mini-conglomerate, Apache's growth proved to be anything but automatic. Its stock price suffered from the investment community's inability to define the company or its mission and its growth was hindered by some businesses' inability to show a profit.

On balance, more subsidiaries were successful than not. By the time Apache began shedding itself of its non-oil-and-gas businesses in the mid-1970s following the shock of the 1973 oil embargo, diversification had proved to be valuable for many reasons. It:

- Ensured Apache's survival until the 1973 revitalization of the energy markets;
- Taught Apache the business of acquisition long before that talent was externally recognized;
- Provided Apache a source of capital, through the sale of subsidiaries, to rededicate itself to oil and gas;
- Forced Apache to define and refine its sense of self and its mission, clarifying the ultimate objective of building long-term shareholder value and an enduring corporate entity.

Diversification, from the first acquisition to the final sale, lasted almost 30 years. As a chapter in the Apache story, it provided those who experienced it with the tools and skills to face the challenges and opportunities of the future.

Emblematic of the many talented, motivated and self-starting entrepreneurs who served Apache's shareholders well, two deserve a special salute as Apache commences its second half-century: Rodger Jensen of S&J Ranch and Lester Weisz of Chief Auto Parts and Supplies.

YOUR PIPELINE TO A WORLD OF OPPORTUNITY

HOW APACHE EXTENDED YOUR INVESTMENT OPPORTUNITIES LAST YEAR

APACHE OIL CORPORATION ANNUAL REPORT 1959

1959 Apache Realty Corporation

Apache's first step away from oil and gas, and the beginning of a period of diversification, was into commercial real estate. Why there? Because Apache could apply the same principles of limited-partnership investment it had already learned and refined in the field of oil and gas.

The company spent $15 million in 1959 and 1960 acquiring interests in four office buildings in Wisconsin and Minnesota. Notable among them was a Minneapolis landmark, the Foshay Tower. A 32-story imitation of the Washington Monument, it was destined to become Apache's headquarters location from the early 1960s until 1984.

For most of that period, the Foshay Tower was a reliable source of annual income. At one time the tallest building between Chicago and the Pacific coast, it generated fees from tourists wishing to see the view from the top to radio and television broadcasters seeking a location for their transmission towers.

Apache sold its real estate division in 1977. While the business did not prove to be as profitable as others Apache entered, it set the tone and pace for diversification. Ownership of the Foshay Tower also imparted a marvelous and unanticipated benefit for the young and growing company: It gave Apache a visible and tangible presence in the city of its founding at a time when all anyone knew about oil and natural gas was that both were cheap and abundant. But everyone knew the Foshay Tower and everyone knew Apache owned it.

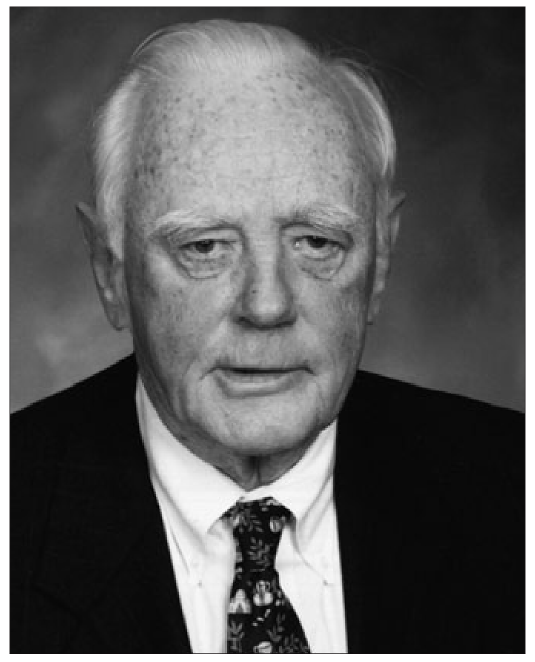
Above: Foshay Tower, Minneapolis Right: Apache Realty Fund logo

1964 Corporate Governance

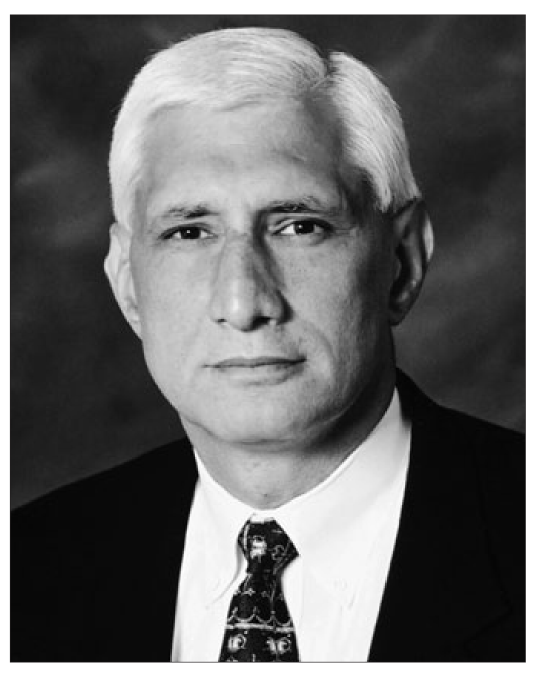
Raymond Plank once observed that a guiding principle of his approach to corporate governance was the firmly held belief that "*there must be continuing and constant communication between the corporation's top two officers*" and, for that matter, between any supervisor and his or her lieutenant. It was not a belief inherently held. Rather, it was a conclusion reached when Plank found himself the only one of Apache's three founders still on the job. With close to 35 years of application, it is a principle that has served the company well.

Charles Arnao resigned in 1956. Truman Anderson and Plank, the owners of two particularly active minds, guided the company toward diversification in complete agreement that Apache's survival was dependent upon it. Direction and the allocation of corporate funds, however, were near-constant sources of debate and friction. Eventually, the two realized that their evolving business philosophies, objectives and long-term goals had begun to diverge. The relationship became unworkable and Anderson left the firm in 1964.

In 1970, John Kocur, a Pittsburgh lawyer and Apache's future president, joined the company. Quickly earning Plank's confidence and trust, he helped guide Apache through more than 20 years of innovative financial transactions, corporate restructuring following the Tax Reform Act of 1986 and the return to international exploration and development. Retiring on the eve of Apache's relocation to Houston, his value to Apache and to Plank is underscored by his continuing presence on, and myriad contributions to, Apache's board of directors.



Top left to right: Raymond Plank, John Kocur
Bottom left to right: Mick Merelli, Steve Farris



Perhaps John Kocur's greatest contribution to strong teamwork at the top was the succession planning he enabled with the hiring of Francis H. "Mick" Merelli and G. Steven Farris in 1988. Merelli, a petroleum engineer who headed Terra Resources, brought to the company the technical knowledge and understanding necessary to effect Apache's transformation to a pure exploration and production company.

At a time when the company's very survival was in question, his operational expertise ensured that Apache would continue to have tomorrows.

Merelli chose to remain in Denver when Apache moved its headquarters to Houston in 1992. Like Kocur, he remains a valuable member of Apache's board.

Merelli's corporate role was soon assumed by Steve Farris, presently Apache's CEO and president. Farris was integral to the implementation of systems that would guide Apache away from the management of oil and gas investment vehicles and toward its successful restructuring. Sharing Plank's strategic vision, he has helped lead Apache to a position as one of the world's top independent exploration and production companies.

For those who know the company, Raymond Plank and Apache are at once inseparable and synonymous. He has guided the company to its position of pre-eminence in the industry. Those who know the company also know that he has done it in full partnership with John Kocur, Mick Merelli and Steve Farris.

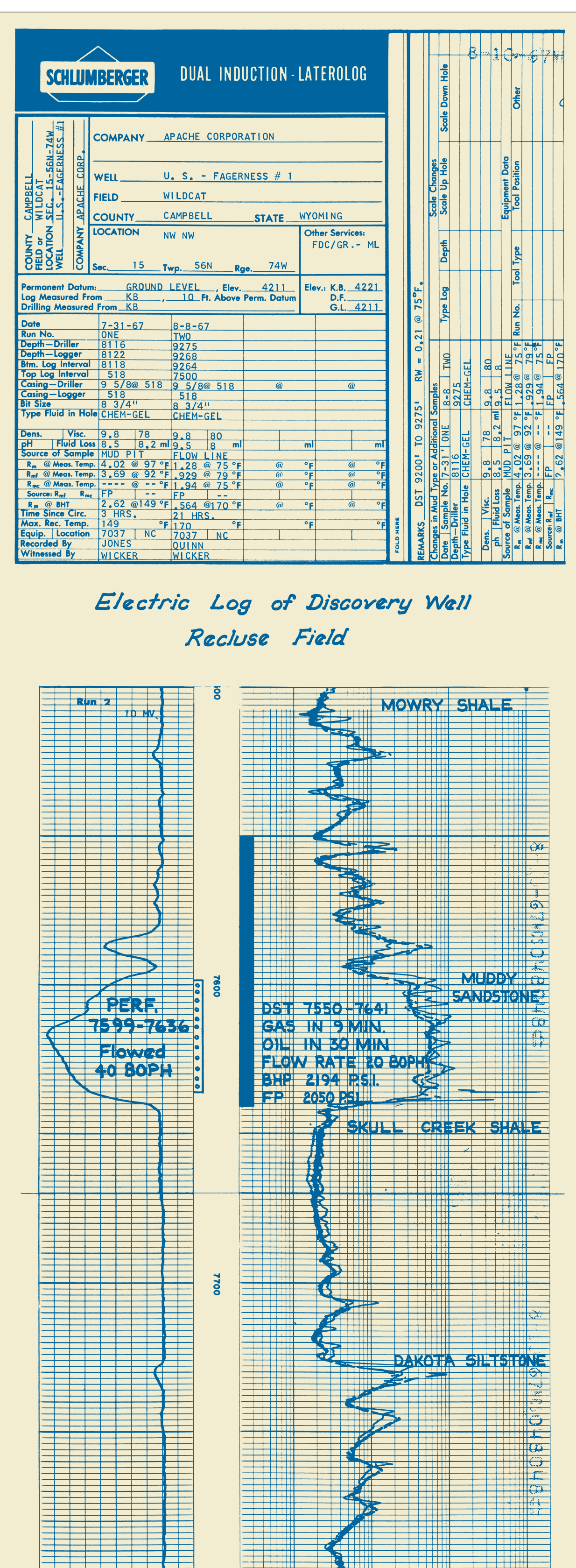
Apache's first major oil discovery occurred in July 1967 when the Fagerness No. 1 well, near the town of Recluse, Wyoming, flowed 1,200 barrels per day from the Muddy formation of the Powder River Basin.

Ultimately accumulating a sizable leasehold position, Apache developed the Recluse Field with 28 wells, 24 of which were productive. The Field was the springboard to Apache's recognition as an independent producer of oil. It was also the foundation that assured Apache's survival in oil and gas when most explorers were throwing in the towel.

The discovery's effect on Apache's capitalization was significant. At the beginning of 1967, the company's stock was trading on the smaller exchanges at levels below $10 per share. By the end of the year, share value had doubled and, by 1969, it had reached the mid-$30s.

Eloquent in his brevity, Plank summarized the impact on Apache of the Fagerness well and the Recluse Field: "*Wall Street took notice.*" In the summer of 1969, Apache Corporation was listed on the New York Stock Exchange.

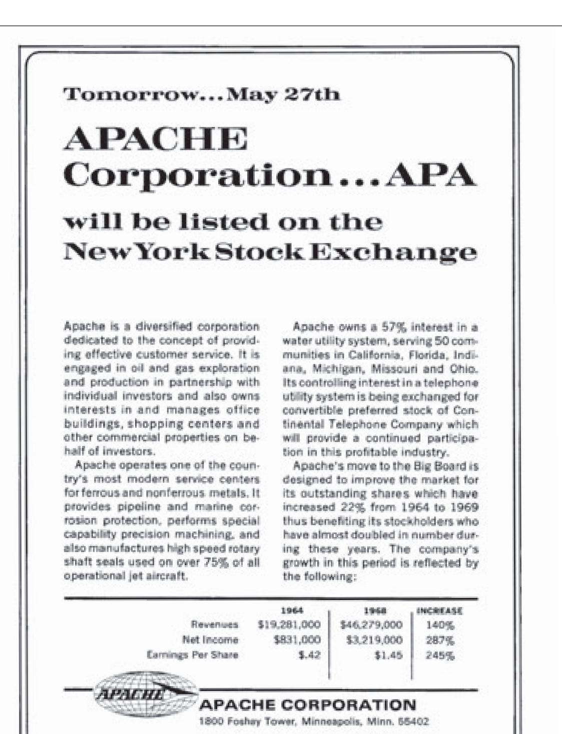
1967 Fagerness No. 1



1969 New York Stock Exchange Listing

On December 6, 1954, one of Apache's original objectives was to gain listing on the New York Stock Exchange. It took not quite 15 years.

On May 27, 1969, Apache Corporation's shares landed on the Big Board, opening at $30.50. Starting with seed capital of $250,000 in 1954, the company's market value had reached nearly $50 million. The credibility it had gained was priceless.



Tomorrow...May 27th

APACHE Corporation...APA

will be listed on the New York Stock Exchange

Apache is a diversified corporation dedicated to the concept of providing effective customer service. It is engaged in oil and gas exploration and production in partnership with individual investors and also owns interests in and manages office buildings, shopping centers and other commercial properties on behalf of investors.

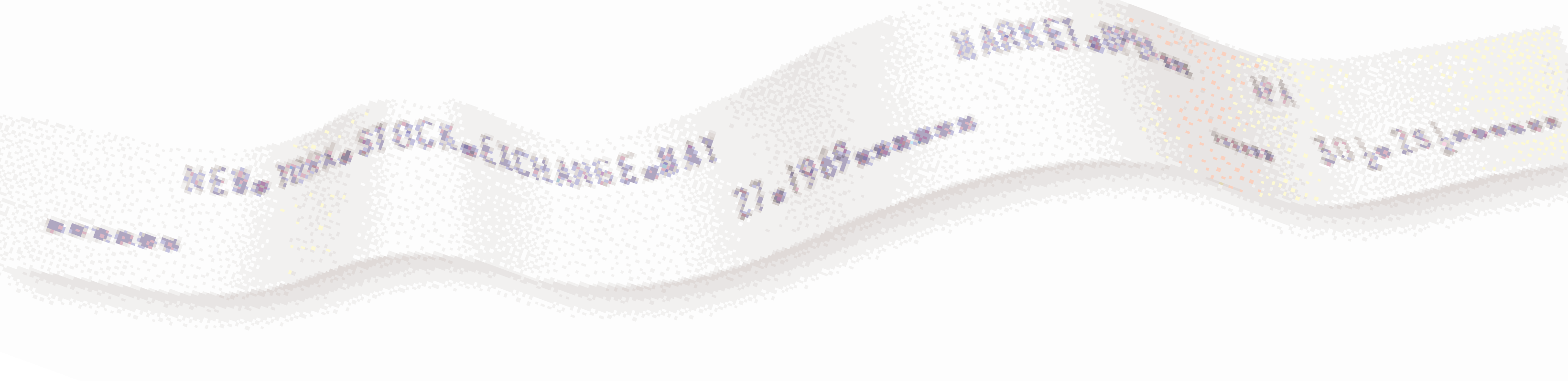
Apache operates one of the country's most modern service centers for ferrous and nonferrous metals. It provides pipeline and marine corrosion protection, performs special capability precision machining, and also manufactures high speed rotary shaft seals used on over 75% of all operational jet aircraft.

Apache owns a 57% interest in a water utility system, serving 50 communities in California, Florida, Indiana, Michigan, Missouri and Ohio. Its controlling interest in a telephone utility system is being exchanged for convertible preferred stock of Continental Telephone Company which will provide a continued participation in this profitable industry.

Apache's move to the Big Board is designed to improve the market for its outstanding shares which have increased 22% from 1964 to 1969 thus benefiting its stockholders who have almost doubled in number during these years. The company's growth in this period is reflected by the following:

	1964	1968	INCREASE
Revenues	$19,281,000	$46,279,000	140%
Net Income	$831,000	$3,219,000	287%
Earnings Per Share	$.42	$1.45	245%

APACHE CORPORATION
1800 Foshay Tower, Minneapolis, Minn. 55402



1970 S&J Ranch

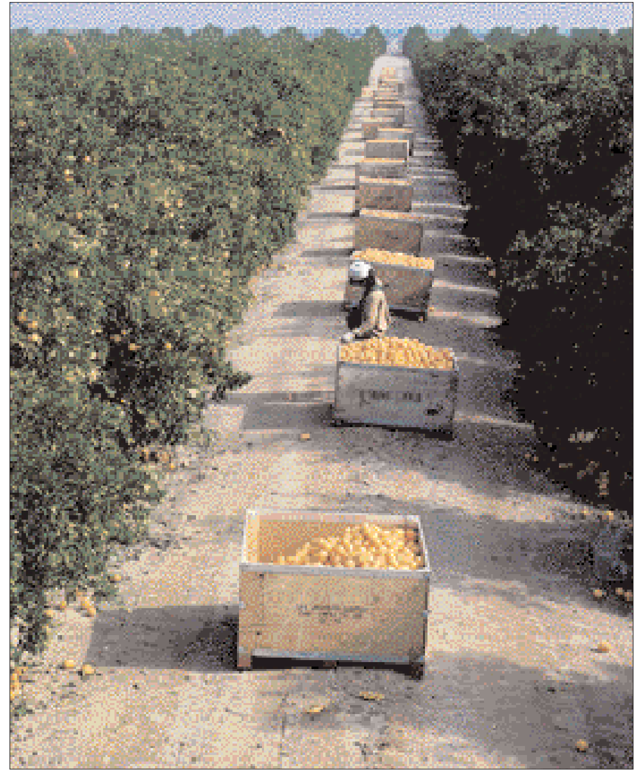
In March 1970, Apache, the highly diversified mini-conglomerate, expanded its concept of limited-partnership financing into the business of agriculture with the acquisition of S&J Ranch in Fresno, California.

S&J, founded at the same time Raymond Plank was seeking clients for his post-war, pre-Apache accounting service, was located in the San Joaquin Valley, the nation's largest producer of fruits and vegetables. In its early years, its sole purpose was to grow and market figs.

S&J prospered and expanded its product line during the 1950s and 1960s. When confronted with the need for additional investment to develop the ranch's citrus operations and the associated lag between investment and the trees' first new crop of fruit, S&J's owners decided in 1969 that the time had come to sell to someone with a longer-term operating horizon.

Apache saw the purchase as a land play through which relatively inexpensive agricultural property would appreciate as Fresno expanded and absorbed it for further residential and/or commercial development. The land play fell dormant when Fresno's expansion surrounded and by-passed the ranch. Just as well, for S&J was and continues to be a very profitable operation.

Under Apache's management, and owned through what were known as the Grove Land Programs, S&J expanded its growing operations to include five crops: citrus (sold primarily under the Sunkist label), figs, pistachios, almonds and olives. It ultimately became one of the largest producers of pistachios in the country.



S&J, likely the most stable and profitable of Apache's non-oil-and-gas subsidiaries, was more than just an important and reliable contributor to Apache's net income. Each year, as the holidays approached, headquarters hallways in Minneapolis and Denver overflowed with bushels of fruit, nuts and citrus candies. Each year, Apache volunteers and high school students sponsored by Junior Achievement ordered 40-pound bags of pistachios, repackaged them in one-pound containers, and sold them at a healthy margin. And every year, to this day, Grove Land investors have received a return on their investment.

Apache sold S&J and the Grove Land Programs to the Dole Food Company for $69.2 million in October 1987. That capital was a significant contributor to Apache's survival following the oil and gas price collapse of 1986.

As the last of the non-oil-and-gas subsidiaries, the sale of S&J marked the end of Apache's diversification away from oil and gas and signaled the beginning of a company focused solely on building a world-class independent oil and gas enterprise.

1971 Apexco

Apache's diversification in the 1950s and 1960s in order to ensure its own survival had accomplished the objective, but not without creating new challenges. Wall Street analysts had difficulty seeing synergies among Apache's unrelated businesses. Management, sensing a subtle strengthening of the long-term prospects for oil and gas, felt itself drawn in too many directions and unable to bring sufficient care and attention to Apache's core business. And oil and gas program unit holders, recognizing the long-lived nature of their drilling-fund interests, were developing a growing and unmet appetite for liquidity.

Responding to these challenges, Apache Corporation formed Apache Exploration Company (subsequently Apexco) as the oil and gas operating arm of the corporate parent's drilling programs. As a publicly held entity with Apache holding 60 percent of the outstanding shares, Apexco offered program unit holders liquidity by giving them the option to exchange their illiquid program units for stock, issued at $10 per share, in the new company. As this was the first-ever exchange of program interests for publicly traded stock, the creation of Apexco required SEC approval. Once obtained, the transaction was widely acclaimed for its innovation.

With technical staff contributed by Apache and its own board of directors, Apexco brought a renewed focus to the parent's original business. Timing also proved to be propitious, as the oil embargo of 1973 propelled commodity prices and Apexco's share values forward.

1975 APEXCO ANNUAL REPORT

By 1976, Apexco stock was trading near $28 per share, more than double the price of its parent. “*We were particularly concerned that a hostile buyer could gain control of the subsidiary simply by acquiring the parent,*” said John Kocur. When Natomas North America offered to purchase the subsidiary for $127 million, or $31.50 per share, Apache jumped at the opportunity. The largest single transaction up to that point in the company’s history, it was a home run for shareholders once worried about liquidity.

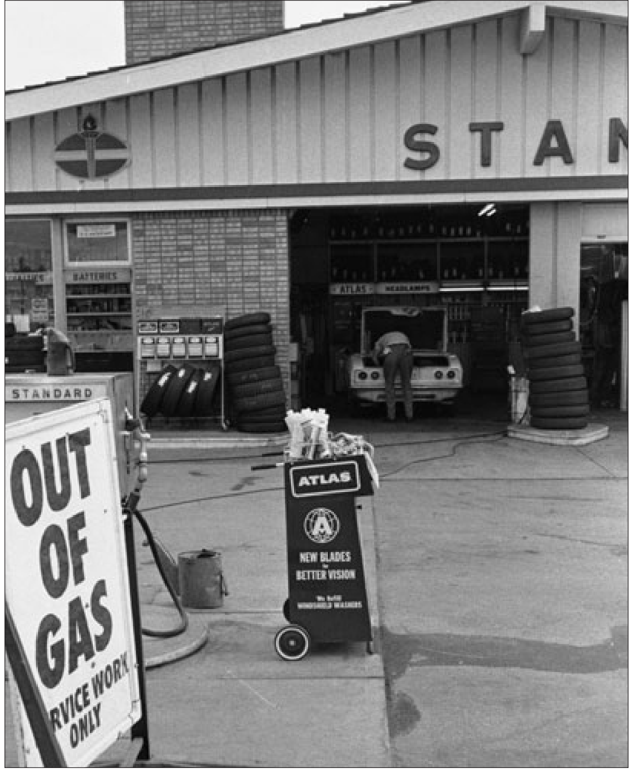
At face value, those shareholders received a multiple return on their $10 investment. But the tax deductions they previously realized on their program units reduced their cost to a fraction of that amount and multiplied their return accordingly. Raymond Plank best summarized it: “*Everyone — our employees, shareholders and program investors — was supposed to win. And everybody did.*”

The story did not end there. The sale of Apexco liquidated Apache’s oil and gas interests. Literally betting the company’s future, Apache formed new drilling funds and, along with investor dollars, poured its share of the sales proceeds into an exploration program on Oklahoma’s North Block that replaced Apexco’s reserves in two years and launched the rebirth of Apache Corporation’s oil and gas operations.

And again, the story did not end there. Fully cognizant of unit holders’ continuing desire for liquidity, Apexco proved to be the experiment that later gave birth to Apache Petroleum Company. But that’s another defining moment.

1973 Oil Embargo

In October of 1973, the Organization of Petroleum Exporting Countries began to reduce exports of oil to western nations that supported Israel. Eventually, in addition to the production cuts, most members declared their intent to stop selling oil to the United States until it abandoned its Middle Eastern ally.



The impact was immediate, dramatic and traumatic. Oil prices quadrupled and gasoline prices climbed from $0.25 per gallon to over $1.00. Never had the price of an essential commodity multiplied so quickly.

The embargo lasted less than two months. Long gas lines and closed gas stations notwithstanding, history suggests that there was no real supply shortage. The businessmen of OPEC, after their symbolic gesture, proved to be more interested in a revenue stream than an embargo. Yet the price of a barrel of oil, always volatile, never returned to pre-embargo levels.

Why is this important to Apache? The 1973 Oil Embargo, and the higher pricing environment it spawned, convinced Apache's management that oil and gas could finally support long-term growth and profitability. With its original business resurgent, Apache decided the time had come to refocus primarily on energy. The period of active and aggressive diversification was essentially over and the selling of all non-oil-and-gas assets was soon to begin.

1973 Program 1973-II

APACHE OIL AND GAS PROGRAM 1973

Preformation Partnership Units — Minimum Subscription — $15,000

THESE SECURITIES ARE SUBJECT TO A HIGH DEGREE OF RISK

SUMMARY OF PROGRAM

TERMS OF THE OFFERING

APACHE PROGRAMS, INC.
FOSHAY TOWER
MINNEAPOLIS, MINNESOTA

Prospectus as of October 1972

Apache gave birth to the business of SEC-registered oil and gas drilling funds and blazed many innovative, investor-friendly trails within that business before tax-law reform brought it to an end in 1987. One of the Apache funds, Program 1973-II, was the single most successful limited-partnership drilling fund in Apache's history.

Because of the tax-incentivized nature of drilling funds, the true measure of their success was their after-tax return on investment. Should the before-tax return be positive, all the better.

For an original one-unit investment of $15,000, Program 1973-II achieved before-tax payout in its first year of operations. By the time it was liquidated in 1993, it had returned over $300,000 per unit, delivering a before-tax return in excess of 20 to one.

There is something to be said for timing. Just before 1973-II was formed, one of Apache's long-term investors had taken a privately held company public, generating significant income and the need for tax shelter. Whereas most investors generally purchased a unit or two, she bought 33 1/3, representing an investment of $500,000. And she thought she had tax problems going in!

1974 Buchan Field, UK North Sea

On June 17, 1974, Apache (through its Apexco subsidiary) announced its first North Sea discovery.

Apexco had previously acquired a one-third interest in the properties of the Transworld Petroleum Group. Among them was a license in the United Kingdom North Sea covering Blocks 21/1 and 21/6.

Located 94 miles northeast of Aberdeen, Scotland, the discovery well flowed at rates up to 2,200 barrels per day from a Jurassic interval extending from 9,498 feet to 9,950 feet.

In 1975, two delineation wells were drilled on Block 21/1. The first, completed in September, indicated an oil column in excess of 1,500 feet — one of the thickest encountered in the North Sea at that time. In a test of four different intervals, the well flowed at a combined rate of 18,827 barrels per day. Following the completion of this well, the field was named Buchan.

Apexco's 1975 annual report provides historical perspective on the discovery and the play, particularly in the context of an Apache that exited the North Sea in 1977 through the sale of Apexco, only to return 26 years later through the acquisition of the Forties Field from BP:

"The United Kingdom North Sea was the focal point of industry exploration in 1975. Because Europe has relatively little petroleum production, a major effort is under way to develop additional North Sea oil-producing capacity. The industry made 24 discoveries during 1975 — one less than the total number for the previous five years. First production began from the United Kingdom sector during the year and British government sources estimate that half of the 14 oil fields declared commercial to date will be on stream in 1976. In the year ahead, emphasis is expected to shift from exploration to development drilling.

Despite the opportunities to build substantial reserves, North Sea explorers — including Apexco — face some serious but not insurmountable problems:

- Costs have spiraled upward at an astronomical rate;
- North Sea weather and water depths pose difficult operating conditions;
- Political uncertainties, related to government participation and petroleum taxes, remain an element of risk.

Notwithstanding the risks of this geographic and economic environment, the industry has acknowledged the future value of the substantial oil reserves located in the area by continued investment in exploration and development. With experienced judgment and judicious planning, North Sea operators are expected to have sufficient economic return to justify the exploitation, in a timely manner, of reserves found to date."

A final thought 30 years later: Buchan is still productive. Its oil flows east in a pipeline to Apache's Charlie platform at Forties before entering the BP line and moving onshore. Apache is handling North Sea oil today that it discovered 30 years ago.

1977 Divestiture

In 1977, Apache set forth an orderly timetable for the divestiture of the company's non-oil and gas assets.

At just over 22 years of age, Apache had survived because it became a mini-conglomerate. Always an oil and gas company at heart, it had begun to diversify in the late 1950s when oil and gas prices, lower than many of us today can either remember or imagine, showed no long-term potential for appreciation.

In the early 1970s, management struggled with the challenge of continuing to grow a company through the accumulation of largely unrelated businesses. The 1973 oil embargo hastened an industrial slowdown that had already begun and confirmed management's belief that oil and gas prices would, inevitably, begin to rise to sustainable levels previously unseen in the industry.

John Kocur said it best: "*If we hadn't built an income-generating group of industrials when the bottom fell out of the oil business, we wouldn't have been able to create Apexco. Then, if we hadn't sold it in 1977 for a total of $127 million — of which Apache's share was $76 million — we couldn't have swung Apache directly back into oil and gas in the late 1970s. Exploration costs were very high then, but excellent earnings possibilities were waiting for the risk-takers.*"

By selling its non-oil-and-gas subsidiaries, Apache simultaneously streamlined itself and raised the necessary capital to finance a major increase in drilling.

"These sales are in accordance with our direction of concentrating our resources on oil and gas exploration and development"

Raymond Plank, August 1977

The equipment, tools, supplies and accessories of Apache's American Machine & Tool subsidiary were sold at auction in late 1976.

Over the next several years, Apache sold its real estate interests, its industrial and agricultural operations, its broadcasting business, its retail auto-parts stores and its public utilities. Gone were the Foshay Tower (the company's Minneapolis home), the Apache Mall, KICS AM/FM Radio, Chief Auto Supply and Chieftech Industries, Midwest Walnut, Burns Manufacturing Company, Woodland Container Corporation, Gits Brothers Manufacturing Company, National Crane Corporation, Apache Precision Machining, Apache Plastics and Juno Tool and Plastic Corporation, among others.

The last subsidiary to go, and perhaps the one most dearly missed by employees who remember the holiday gifts of California fruits and nuts, was S&J Ranch. With its 1987 sale, the diversified days of Apache had come to an end.

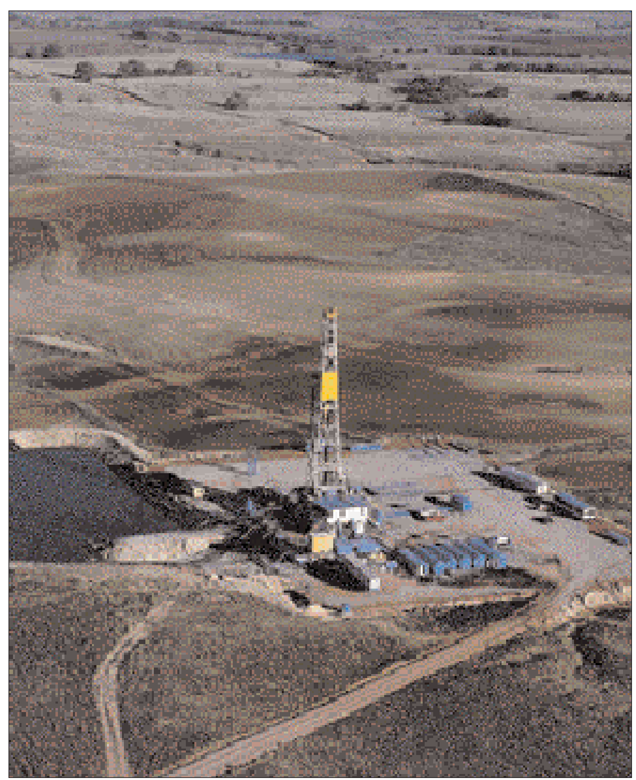
Apache's Anadarko Basin acreage was built around the 1977 acquisition of the "North Block" from GHK. With the deregulation of natural gas below 15,000 feet, Apache controlled one of North America's great natural gas plays.

Anadarko Basin

TEXAS/OKLAHOMA

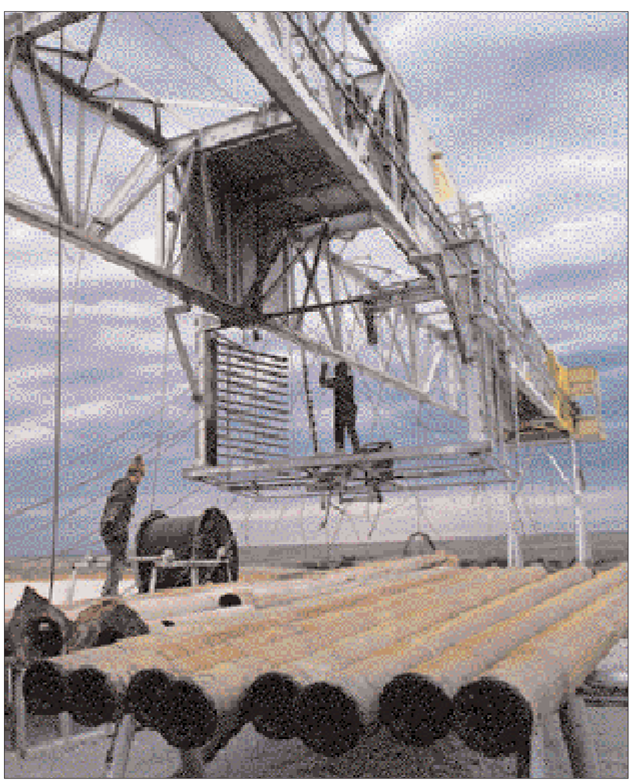
1977 North Block

The North Block acreage acquisition provided Apache a second beginning in oil and gas.



The year 1977 was an interesting time for those Apaches wishing to build an oil and gas concern for the long term. The company had sold its oil and gas subsidiary, Apexco, to Natomas, removing itself from the oil and gas business. It was, at the least, a very risky play.

As a 60 percent owner of Apexco, Apache was flush with cash from its share of the sales proceeds. Anticipating the sale, it had begun negotiations with GHK, a mid-continent independent that controlled the North Block, a large swath of acreage in Oklahoma's Anadarko Basin, but didn't have the capital to develop it. Apache and GHK reached an agreement under which Apache would commence a drilling program and fund GHK's share of expenses. Apache got acreage. GHK got carried.



There was a particularly contrarian twist to the deal: The North Block acreage represented deep and untested opportunity where drilling costs were too high for then-regulated natural gas prices to allow an economic return. GHK's founder, Bobby Hefner, lobbied Congress to deregulate gas below 15,000 feet and, much to everyone's surprise, was successful in doing so. Overnight, Apache found itself controlling acreage that would become one of the greatest natural gas plays in the Mid-continent.

The North Block gave running room to all of Apache's public drilling funds for the next decade and provided the company the breathing room necessary to survive and thrive in the energy business. In many respects, the oil and gas entity that was born in 1954 disappeared with the sale of Apexco. It reappeared in the North Block.

1980 Pension-Fund Financing

In a series of innovative transactions from 1980 through 1986, pension-fund financing provided a source of funds when bank debt was either unavailable or too expensive. Through vehicles structured as limited recourse notes that put a floor and a ceiling on investor performance or as net profits interests that allowed full up- and downside investor participation, Apache obtained over $700 million dollars in commitments without burdening its existing borrowing capacity.

For three years after the 1977 sale of its Apexco subsidiary, Apache used the proceeds to fund much of its operational obligations. Its capital and borrowing capacity, however, fell far short of its drilling opportunities. Lacking access to the luxury of low-cost capital it has today, the company needed alternative sources of financing.

Apache's financial engineers in Minneapolis had observed the exponential growth of pension-fund money under professional management. Sensing an opportunity in the challenge that fund managers faced to keep their assets growing, Apache's personnel determined that a small but growing portion of fund resources were invested in relatively high-risk, high-reward sectors of the economy, oil and gas among them. Working closely with representatives of private- and public-sector pensions, Apache was able to structure financings that were competitively priced, gave the company room to grow and complied with the funds' very strict sense of acceptable risk tolerance. By 1980, Apache and a group of funds had structured a workable agreement, opening the door to a series of transactions.

Closing on funding for the 1979 and 1980 drilling funds. Clockwise from top left: G. Charles Hann, John Kocur, Kenneth Anderson, Raymond Plank, and Bank of America's Larry Nerheim

Pension fund financing provided Apache with a bridge to critical mass and cultivated sources of capital not previously available.

The test run provided Apache $65 million for its share of tangible expenses related to the seven phases of the 1979 and 1980 drilling funds. So well did that vehicle perform that within the next four years Apache obtained $380 million in commitments from the likes of IBM, General Motors and the Minnesota State Board of Investment, among others, to cover its obligations related to leasehold and equipment expenditures in a joint venture with Shell in the Gulf of Mexico. Another $343 million in three separate financings followed. Two of these vehicles are still in existence, producing regular quarterly distributions for the investors and a revenue stream for Apache.

Pension fund financing provided Apache with a bridge to critical mass and cultivated sources of capital not previously available. The financial innovation was consistent with Apache's creative approach to its business.

In the vein of a historical side note, Apache's ability to access pension-fund capital caught the eye of one of the company's partners in the 1979 and 1980 programs. Amoco was impressed with its independent partner's financing capabilities and remembered that skill and ability to perform when it came time to negotiate the MW Petroleum transaction in 1991.

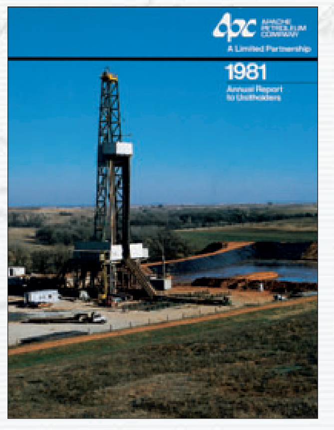
1981 Apache Petroleum Company

When Apache turned 30, many considered Apache Petroleum Company (APC), the country's first master limited partnership (MLP), to be the most significant development in the company's history. Although several events in the years since could compete for a higher ranking, APC will always be one of the single most formative events for Apache at 50. "*Not only did it provide significant earnings to the corporate parent and an unheard of degree of flexibility for its investors,*" said John Kocur, "*it planted the seeds for the consolidation of interests and growth through acquisition that would come to define the Apache that emerged from 1986 tax-law reform.*"

Even though Apache was still in the business of managing someone else's assets, the long-term lesson learned from APC was one of the importance of critical mass.

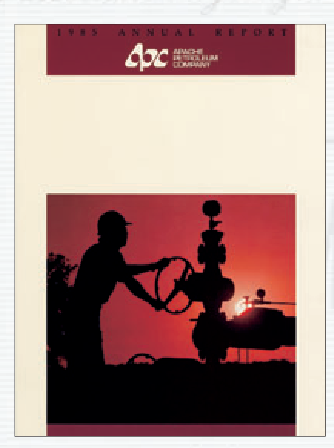
Prior to the formation of APC, Apache Corporation's oil and gas assets were defined, for the most part, by its general- and limited-partner interests in the drilling funds it sponsored. By definition, those interests were scattered and piecemeal, governed by the structure of the individual oil and gas programs through which they accrued. Difficult to aggregate, Apache could not capitalize on any synergy or critical mass those interests might represent.

APC, with Apache Corporation as its general partner, was born in 1981 through a consolidation of interests in 33 of Apache's oil and gas programs formed between 1959 and 1978. Thanks to the trail blazed by Apexco, APC's units were traded on the New York Stock Exchange, providing liquidity for unit holders. APC took the Apexco model a step further, however, preserving the tax advantages of the unit holders' original limited partnership interests.



The consolidation of those previously illiquid program interests into a market-traded MLP provided investors with a rare combination of opportunities: more efficient operations; liquidity; tax shelter; cash flow; potential for market appreciation; and the opportunity for future growth through drilling and/or acquisition. For Apache as its general partner, APC firing on all those cylinders provided a stream of fees that, for a time, represented the largest single component of the parent's net income.

The initial 1981 program consolidation was immediately accepted in the marketplace. With drilling success, growth through a $400 million acquisition from Dow Chemical Company and another consolidation in 1983, APC was larger after two years of operations than its corporate parent. With a demonstrated ability to support quarterly cash distributions, success led to credibility, credibility to mass and mass to further acquisitions. By 1986, when APC shared the $428 million Oxy acquisition with Apache, total acquisitions from inception exceeded $1 billion. Total assets peaked at $898 million in 1985, six years before the corporation reached the same threshold.



Regulatory reform triggered by the Tax Reform Act of 1986 eliminated many of the tax-advantaged reasons for investing in APC and its end quickly followed.

APC's existence was brief, lasting but seven years. Its track record of growth was the model the corporation would follow when it withdrew from the program business and began to consolidate its own interests. As an acquisition vehicle, APC demonstrated the benefits of mass and pointed the way to Apache's future.

Editor's Note: When Apache's financial engineers conceptualized tax-advantaged partnership interests trading on the NYSE, four different law firms said it would never happen. When a fifth firm believed in Apache's idea, a new industry was born.

"Tall oaks from little acorns grow."

1981 Shell Joint Venture

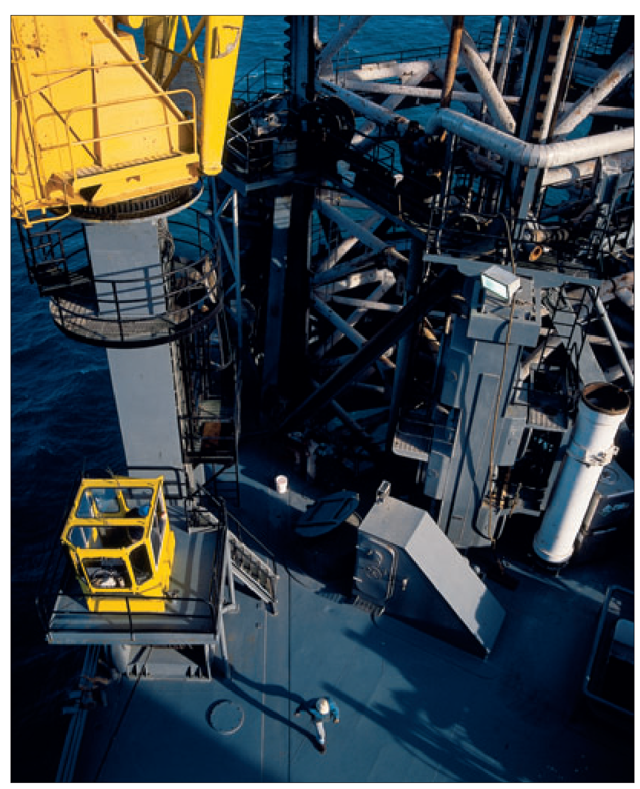
The non-operated interests Apache acquired through participation in the Shell Offshore Joint Venture proved to be the gateway to Apache's present position as the largest held-by-production leaseholder and fourth-largest producer on the Outer Continental Shelf of the Gulf of Mexico.

In 1980, the Gulf of Mexico was the most productive hydrocarbon province in the United States. Controlled primarily by the majors, it was largely inaccessible to the independent sector. Although Apache had participated in a few wells, its presence in the waters offshore Texas and Louisiana was negligible, defined primarily by scattered, non-operated interests. And all of those had been sold in 1977's Apexco transaction.

"*In many respects, the Gulf held the same attraction to Apache then that international expansion does now,*" said Raymond Plank. "*It represented the single greatest opportunity in the United States to access large reserve targets at correspondingly low finding costs.*" The company's recognition of that opportunity led to the strategic decision to seek a partnership through which Apache could, in a meaningful way, begin to get its feet wet.

A year later, Apache was invited to join a small group which held a 25 percent interest in a joint venture operated by Shell. By 1983, Apache and its internal affiliates held an average eight percent interest in 49 prospects acquired at a net cost of $78 million and encompassing more than 70 federal leases offshore Texas and Louisiana. By 1985, Shell had purchased all other partner interests, reducing the joint venture to Shell and Apache only.

Lucite barrel commemorating the oil discovery at South Timbalier Block 295



Offshore operations and technical competency came to Apache with the $428 million Occidental Petroleum acquisition in 1986. Transactions in 1992 and 1994 with Shell and Hall Houston brought an increasing degree of critical mass and made the Offshore Region Apache's most productive core area. The negotiated transaction with Shell in 1999, coupled with subsequent acquisitions from Oxy, Shell and BP, further fired the engine.

In 2003, Apache purchased almost all of Shell's remaining Shelf interests, including many that were original parts of the 1981 Joint Venture. The independent that piggy-backed on the major had, in many respects, replaced it. And it all started with a non-operated interest in 1981.

1981 Ucross Foundation

One day at the end of the 1970s, Raymond Plank — WWII bomber pilot, maverick visionary, founder and chairman of Apache Corporation — stood among the falling plaster, bats and beehives of a second-story room in an abandoned ranch house in Ucross, Wyoming. The company had recently purchased the ranch where the house stood. Razing the buildings appeared inevitable, but looking out on grounds flanked by a big red barn, bunkhouse and a ring of 100-year-old cottonwoods, Plank felt the pull of history.

Built a century earlier, the complex was known as Big Red. It had served as the headquarters for the Pratt & Ferris Cattle Company, a chain of four ranches in northeastern Wyoming. An imposing visual landmark on the prairie, Big Red was on the stagecoach route that served Buffalo to Clearmont (1891-1911). Tepee rings on the surrounding hills testified to an earlier history as Indian hunting grounds.

Plank challenged friends and associates to reinvent and restore Big Red in the 20th century, rendering the site as relevant to people in the future as it had been to those in the past. The Ucross Foundation was incorporated as a non-profit organization, and the 22,000-acre property continued as a working cattle ranch. The Foundation's mission is three-fold: (1) A residency program providing uninterrupted time and space in which to nurture the creative spirit for selected artists and writers; (2) meeting facilities for community and regional consensus building; and (3) a model of land stewardship integrated with ranching in the open spaces of northeast Wyoming.

The Foundation accepted its first residents in 1983 and since that time has hosted more than 1,000 artists — including painters, poets, sculptors, novelists, photographers, filmmakers, music composers, playwrights and others — from across the United States and around the world. Applications

are reviewed by an independent committee and selected individuals are awarded residencies of two to six weeks at Big Red, including private studios and living spaces, meals and the extraordinary experience of the High Plains landscape. In recent years, the foundation has established partnerships with other national arts organizations such as the Sundance Institute, the Ernest Hemingway Foundation, PEN/New England, CalArts and the Herb Alpert Foundation, to identify and bring accomplished artists and writers to Ucross.

Many participating artists choose to present their work publicly, providing a significant cultural resource for local communities. The Big Red Barn features a gallery which presents four annual exhibitions of contemporary art of the west as well as historical exhibits of regional interest. Conference facilities in the Loft of the barn and tours of the historic Big Red Ranch House also draw many visitors year-round.

The Ucross Ranch is a developing model for ecologically sound, holistic ranching practices. In 1999, the Foundation placed a conservation easement, held by the Wyoming Chapter of The Nature Conservancy, on more than 12,000 acres of the ranch. As part of this initiative, the Foundation has broadened its programs to include the natural sciences and land issues of the American West in the 21st century.

Today, the ranch house is listed on the National Historic Register and rings with the energy of commitment to the historic and cultural community of the West.

This article ran in *Wyoming: A 20th Century History of Its Citizens*, published by Heritage Media Corporation. It has been updated here by Sharon Dynak and Michelle Sullivan, both of the Ucross Foundation.

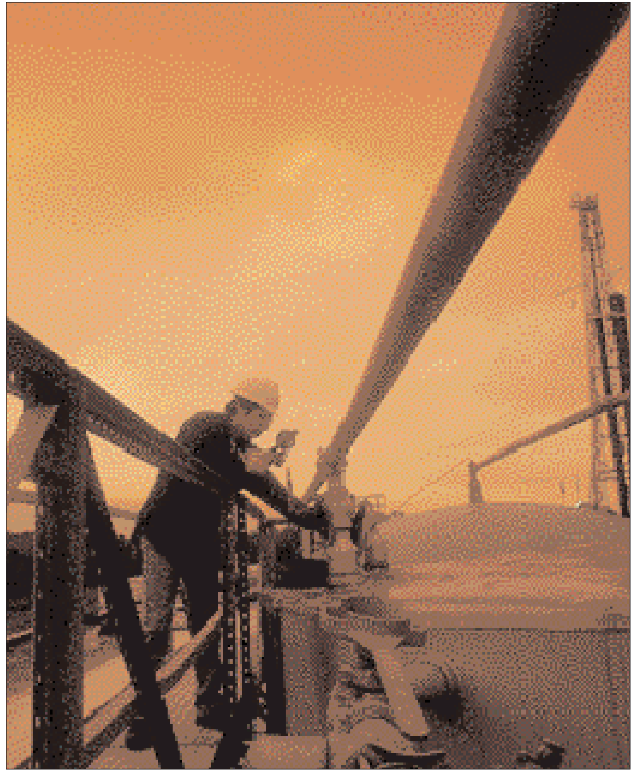
1982 Dow Acquisition

At first blush, the $402 million Dow Chemical Company transaction is important because it marked the beginning of the company's growth through acquisition as well as the drill bit. It also did many of the things large acquisitions are supposed to do: It broadened and complemented the scope of Apache's operations; it contributed needed income; and it paid out in four years.

Less obvious yet more significant is that Dow accepted, as partial payment, units in the newly formed Apache Petroleum Company (APC), the country's first Master Limited Partnership.

More than any single event, that recognition gave APC credibility by transforming its units into an acceptable currency for future transactions, simultaneously transforming the MLP into an industry player.

APC and Dow: early seeds of critical mass.



1983 Killing the Key Well

The measure of a company is often not so much its success as how it responds to crisis. The blowout of the Key No. 1 well in Wheeler County, Texas, represented just such a test.

In October 1981, while completed and waiting on a pipeline connection, segments of the Key's tubing, casing and Christmas tree took flight. The resultant uncontrolled gas flow from a formation below 16,000 feet was estimated at 90 million cubic feet per day. It may have been higher. Residents of the area thought it might well have been "the world's biggest gas leak."

With a contract to sell the deep, unregulated gas for approximately $8 per Mcf, royalty- and working-interest owners saw hundreds of thousands of dollars vaporize daily.

Technical personnel from Apache and the industry worked ceaselessly over the next 16 months to control and kill the blowout, one of the largest ever recorded in the United States. Two additional wells, one designed to kill the first and the other to replace it, were drilled from surface locations several hundred feet away from the original. In February 1983, the kill well, using the most sophisticated sensing equipment Apache could find, penetrated the 7 5/8-inch casing of the No.1, poured in cement and stopped the gas flow.

As recounted in *Journey Into Risk Country*, Apache's 30-year history: "The blowout dramatized once again the risk element always so exceptionally present in all oil and gas exploration. Yet throughout the long months when hundreds of workers and technicians labored at the site, and costly salvage vehicles rumbled through the mud and dust, no lives were lost and no serious injury or permanent property damage was sustained during the first blowout ever to occur at an Apache-operated site."

Its response to the crisis was Apache at its finest.

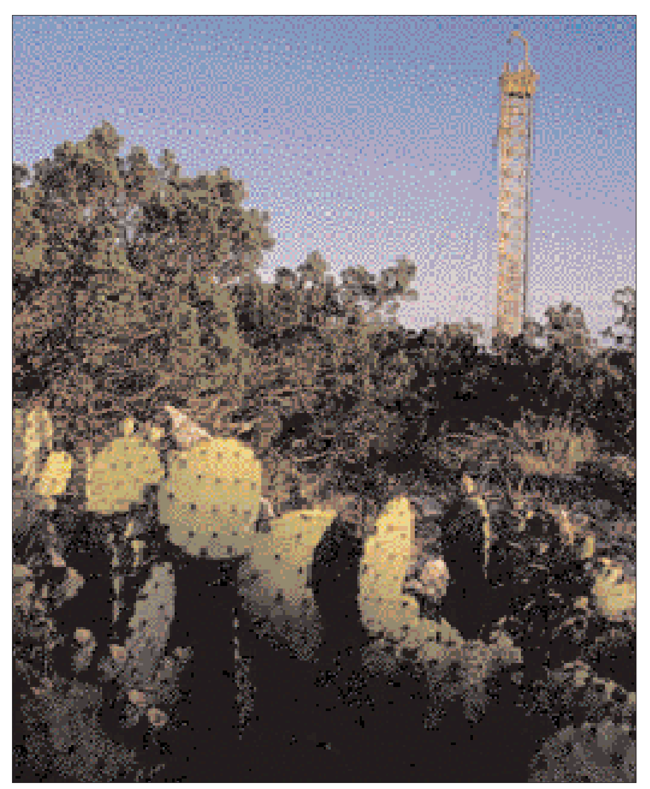
1986 Occidental Petroleum Acquisition

There are acquisitions and there are acquisitions. Many share common traits and, after a while, they can be indistinguishable one from another. Not so the 1986 Occidental Petroleum acquisition, for it ultimately proved to be a transforming event for Apache.

At $428 million, the Oxy acquisition set a record for size, beating that of the Dow acquisition four years earlier. It marked Apache's entry to the Gulf of Mexico as an operator, the logical next step following the company's large, non-operated participation in the Shell Joint Venture. And it provided Apache a large Mid-continent acreage position that blended well with the previously acquired North Block interests.

Immediately following the acquisition, Apache moved its headquarters to Denver from Minneapolis amidst two years of net operating losses. The stock was soon to trade at split-adjusted levels below $3 per share and commodity prices had collapsed. And, in response to the 1986 Tax Reform Act, Apache had withdrawn from the program business. Changing its culture and its structure with survival in the balance, the company set an aggressive goal of achieving $5 million in earnings in 1988, fully cognizant that failure might spell the end.

Oxy was the answer to a prayer. The acquisition gave Apache a huge, held-by-production, Mid-continent acreage position with near-countless, low-risk, high-potential development opportunities ("*low-hanging fruit,*" as the PR guys like to say). In 1988, before anyone had even thought about "acquire and exploit," Apache began an aggressive



three-year drilling program, the results of which propelled the company into the 1990s. Oxy exploitation, coupled with moderate improvement in commodity prices, helped triple the company's reserves and annual revenues, boost yearly earnings beyond the $40 million threshold, double production and net assets, and position the company to successfully compete for Amoco's MW properties in 1991.

Yes, many other things happened in the years between 1986 and 1991, but none was more instrumental than the Oxy acquisition in ensuring that there was a 1992 for Apache.

For those of you wondering, 1988 earnings were $5.4 million.

1986 Tax Reform

The Tax Reform Act of 1986, becoming effective in 1987, marks the beginning of the modern Apache.

By lowering marginal tax rates and limiting the utility of passive losses, the act effectively brought to an end the limited-partnership, drilling-fund business Apache had pioneered. A lesser company, with its bread-and-butter activities legislated out of existence, might have folded. Many did. Wall Street expected as much as the stock hit split-adjusted levels below $3.00 per share. Yet Apache, demonstrating persistence, adaptability and a sense of urgency long before anyone named the concept, converted lemons to such great lemonade that one must wonder if it would have thrived as well had the regulatory environment for tax shelters remained unchanged.

A lesser company, with its bread-and-butter activities legislated out of existence, might have folded.

When Apache was formed, the top marginal tax rate was 91 percent. In the mid-1960s it was reduced twice, first to 77 percent and then again to 70 percent. In the first year of the Reagan administration it reached 50 percent before the 1986 act dropped it to 28 percent, the lowest level since 1917.

The significance of the top marginal tax rate cannot be overstated for a company that was in the business of providing tax-shelter investments. Every reduction in that rate reduced the attractiveness of such investments to the high-income taxpayers who comprised Apache's clientele.

As managing partner of the investment vehicles it created, Apache historically earned its income managing other peoples' money. As those people deserted the business, Apache's very survival became dependent upon its ability to manage its own money and to restructure its approach to the oil and gas business.

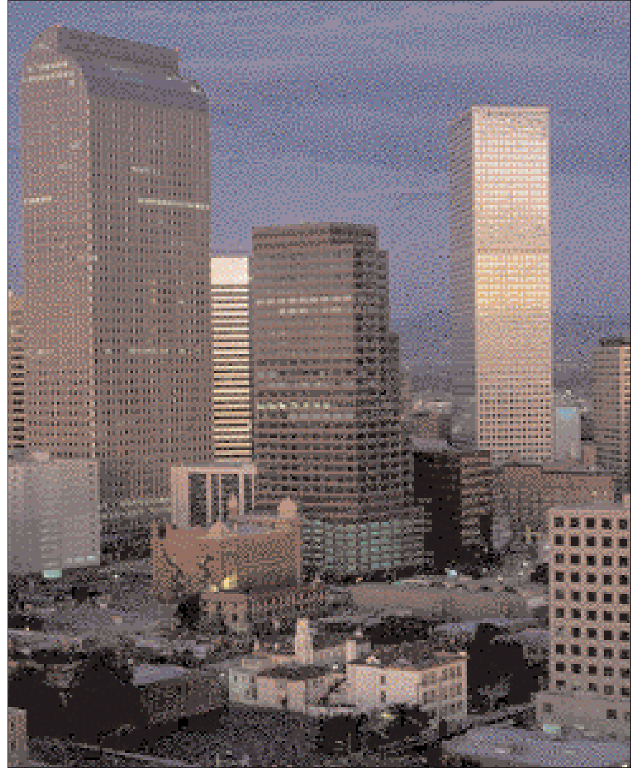
Apache's culture has never allowed it to wait and see what might happen.

Apache's culture has never allowed it to wait and see what might happen. Following the passage of the act, the company moved swiftly to strategically reposition itself: It accumulated its own drilling inventory through an approximate 50 percent participation in the $428 million Oxy Acquisition; it chose to restructure itself as an exploration and production company, ultimately withdrawing from the program business; it moved its headquarters from Minneapolis to Denver in order to tap the latter's abundant supply of oil and gas professionals; it hired Francis H. "Mick" Merelli as its president and G. Steven Farris as vice president of exploration and production to implement the necessary operational changes; it absorbed most of APC's interests upon its rollup; and, by 1988 it had actively begun to exploit the Oxy properties for its own account, providing the production, reserves, cash flow and growth that made 1991's transforming MW acquisition possible.

And what became of Apache's drilling-fund business? At the time the act became effective, Apache had 44 partnerships under management. Having run their normal economic course, most were terminated between 1987 and 1996. As Apache celebrates its 50th year, only one, the Offshore Investment Partnership, remains active. It is the last of its kind.

1987 Move to Denver

Apache moved its headquarters of 33 years from Minneapolis to Denver in 1987. The relocation, lasting fewer than five years, facilitated cultural change and planted the seeds of corporate restructuring, restaffing, revitalization and growth. Denver witnessed the birth of the "new," post-tax-reform Apache.



The move began (although few recognized it at the time) when operational accounting and program management transferred to the Mile High City in 1984. That was a tip of the hand to the resolve Raymond Plank and John Kocur brought to the job of anticipating and adapting to the rapidly changing landscape of Apache's business.

"*Tax-law changes in 1986 brought an end to the business of raising investor capital for public drilling funds and, in many respects, hastened the liquidation of partnerships formed earlier,*" said John Kocur. "*Those same changes, coupled with the concurrent price collapse of oil and natural gas, undermined the ongoing viability of Apache Petroleum Company, the country's first Master Limited Partnership, and set the stage for its rollup in 1988.*"

The Apache that briefly settled in Denver, absorbing the blows of net operating losses in 1986 and again in 1987, was dedicated to restructuring itself as a traditional exploration and production company and hiring the people necessary to make the change. Mick Merelli and Steve Farris came on board in 1988 as president and vice president of exploration and production, respectively. Absolutely focused on growing production, cash flow and earnings while tightening operational discipline in a generally stagnant commodity-price environment, the Merelli-Farris team brought single-minded purpose to exploring, developing and exploiting the properties acquired from Oxy in 1986. Re-energized

The Apache that briefly settled in Denver … was dedicated to restructuring itself as a traditional exploration and production company and hiring the people necessary to make the change.

operations proved to be the springboard to successful restructuring. Steadily improving operational and financial benchmarks (net income recovered from two years of losses to reach $40 million in 1988, total assets increased to $830 million from $503 million, reserves almost doubled to 106 MMBoe from 56 MMBoe) provided a measurable and necessary degree of critical mass and operational confidence. From confidence came the ability to recognize opportunity and from opportunity came the 1991 MW Petroleum acquisition from Amoco.

MW shifted the center of Apache's geographical mass from the Mid-continent to the Gulf Coast and, more than any other event, catalyzed the subsequent move to Houston.

The Apache that departed Denver in 1992 left behind the shell of the program-management company that had arrived five years earlier. The company's metamorphosis was virtually complete. Arriving in Houston was a leaner but no less aggressive entity dedicated to the prospect of becoming and remaining a low-cost exploration and production company. Denver provided the environment, the opportunity and the foundation for the transformation.

1988 APC Rollup

Apache Petroleum Company, at one time larger than Apache Corporation itself, was doomed by commodity-price collapse, the resultant reduction in investor distributions and 1986 tax-law reform. Structured to provide its investors flexibility through liquidity, tax shelter, annual cash flow and the potential for growth through exploration, development, acquisition and market appreciation, it couldn't survive the combined weight of less-attractive, and ultimately phased-out, tax advantages in a period of low commodity prices.

Apache, as APC's general partner, offered unit holders the option to exchange their APC units for shares in Apache Corporation or a newly created corporate entity, Key Production Company (now Cimarex Energy). At the conclusion of the exchange offer, Apache assumed approximately 74 percent of the interests previously held by APC. With those interests came equivalent reserves of 233 billion cubic feet of natural gas. That addition expanded the corporate parent's reserves by 70 percent.

The rollup of APC was another step among several taken in the late 1980s to withdraw from the investment management business, consolidate the corporation's interests and expand again the definition of critical mass.

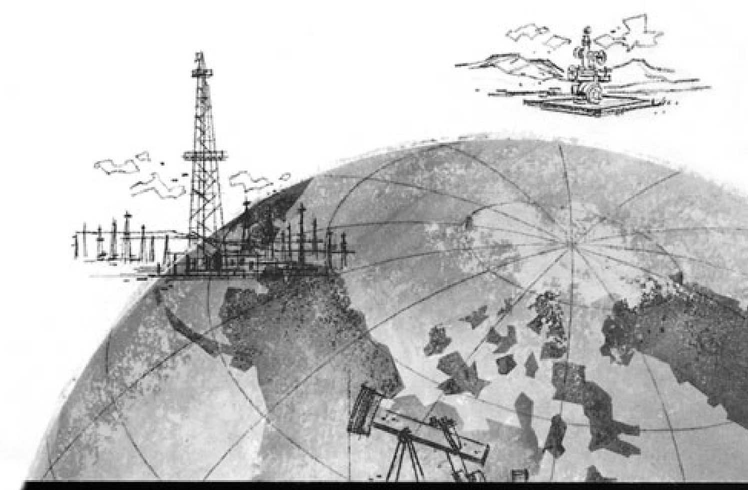
1988 Going International

Some defining events are more so than most.

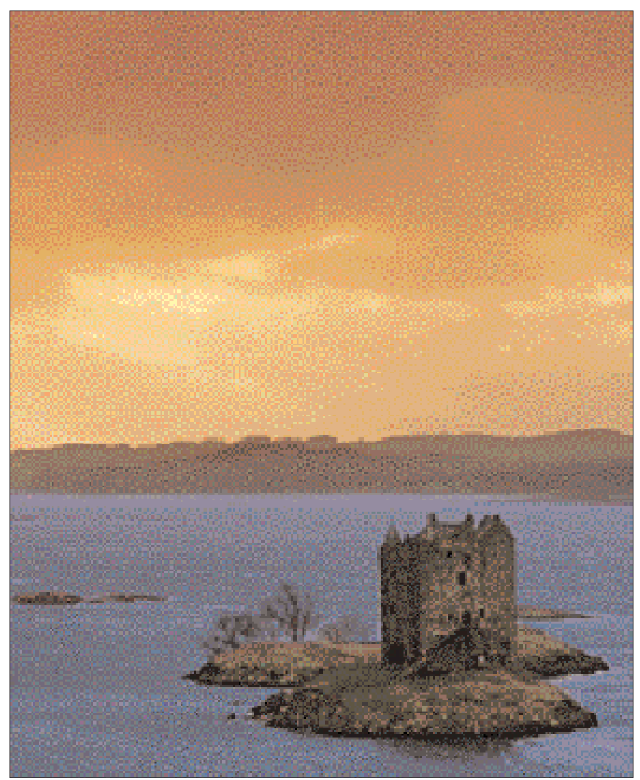
Given that more than half of Apache's reserves and most of its growth potential are now outside the United States, the strategic importance of seeking long-term growth options internationally seems obvious today. But it was not that long ago that all of Apache's oil and gas assets were in the United States. The shift began slowly when, after a series of unsuccessful wildcats, a small 1991 Australian acquisition put one percent of Apache's reserves on the international subsidiary's books. It took another 10 years for the various international core areas to reach parity with the domestic parent.

It's true: It does take 20 years of hard work to be an overnight success.

The maturity of the United States as a hydrocarbon province has long been recognized, as has the relative attraction of larger international reserve targets and their correspondingly lower finding costs. Apache has had international aspirations since the mid-1970s when the Apexco subsidiary, acquiring non-operated interests, explored in the North Sea, the Gulf of Suez, Tunisia and Peru. Commercial success came with the discovery of the still-productive Buchan field in the UK North Sea.



Going International



In the aggregate, Apache's early international forays were not successful and ended with the sale of Apexco in 1977. While the learning curve was steep, one lesson was well understood: Apache could not rely on third-party expertise. It is not mere coincidence that the company operates most of its present day international assets.

The company's return to the international arena was delayed for several reasons. Domestic operations needed to be rebuilt after the Apexco sale. Management's attention was focused on new drilling programs, the creation of Apache Petroleum Company, continuing price volatility, the restructuring of the business following 1986 tax reform and the divestiture of the company's non-oil-and-gas subsidiaries, the last of which was sold in 1987. Shortly thereafter, Apache rededicated itself to becoming a true exploration and production company with a diversified portfolio of domestic and international assets.

Today's international success was neither instant nor automatic. In its early stages, international diversification required great sacrifice and a long-term perspective as it diverted capital away from operations that otherwise might yield near-term cash flow. As cash flow was the primary driver of the stock price, the company's struggle to establish viable international subsidiaries created a large gap between capital flowing out and revenue flowing in. Apache's share price and earnings in the early 1990s reflected that clash.

Since 1989, Apache has entered and exited Argentina, Aruba, France, Gabon, Indonesia, Poland and offshore the Congo, Angola and the Ivory Coast. Opportunities in

several international basins were explored and, ever so gradually, those where the geologic potential and political/financial regimes were acceptable were identified. Acting on that refined sense of place and the need for large acreage positions with considerable exploratory running room, international slowly began to take the shape it reflects today. First there was Australia in 1991, followed by Egypt and China in 1994, Canada in 1995, Argentina again in 2001 and the UK North Sea in 2003.

When the first Australian reserves of 600,000 barrels hit the books, they were lost in the sea of domestic's 187 million equivalent barrels. By 1995, international accounted for almost one-fifth of 420 MMBoe in reserves and in 2000, two-fifths of 1.1 billion Boe. At year-end 2003, with more than half of Apache's 1.6 billion Boe in reserves, international had become larger than Apache was at any time in its first 45 years.

Financially, the international bet is paying off. The capital spent in the early years of little or no return put the company and its shareholders in position to capitalize on today's supply shortages and growth opportunities. While the wisdom of the gamble may at one time have been questionable, Apache's international efforts have put it and its shareholders in the right place at the right time.

1991 Acquire and Exploit

If there is but one thread of consistency in a half-century in business, it is that Apache is an acquisitive company. Before "acquire and exploit" became one of the strategies propelling the company forward through the 1990s and into the new century, Apache honed its skills of deal-making, financial innovation, acquisition, rationalization and exploitation almost from the date of its founding and certainly through the period of its diversification. It didn't matter that the company learned its trade on non-oil-and-gas assets, for it was that skill which allowed the company to survive when oil and gas alone were not viable.

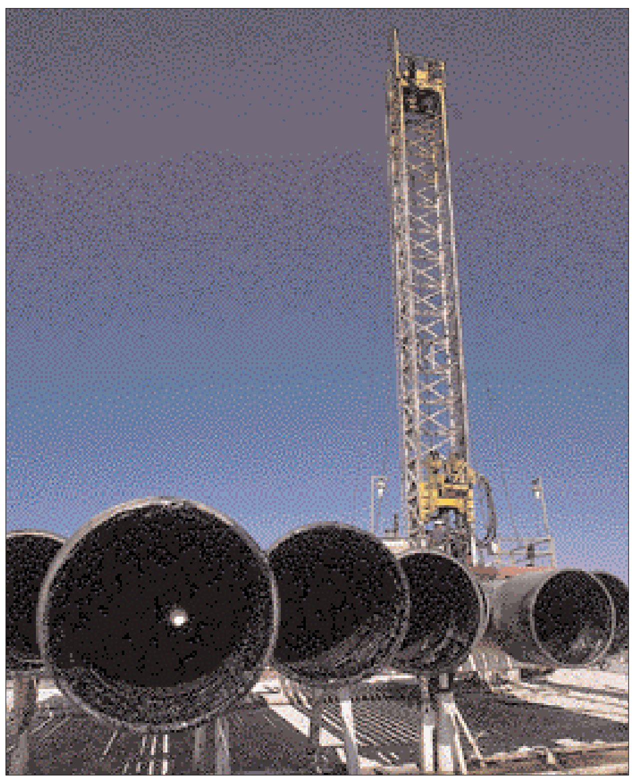
Coined by Apache, "acquire and exploit" is neither proprietary nor rocket science. It is predicated upon a simple assumption which, more often than not, has proven to be the case: Properties acquired from the majors will have sufficient reserve upside, through the application of new technologies and aggressive exploitation, to provide a very attractive return on the original investment. The trick, and one in which Apache has been most fortunate, is in the timing, the fit and the evaluation.

In its most basic form, "acquire and exploit" entails the negotiated purchase of properties, the sale of those deemed non-strategic, the reduction of debt with the sales proceeds and low-cost exploitation of the remaining inventory — all accomplished with Apache's legendary sense of urgency.

As the market and the environment have evolved, so too has Apache, adapting the acquisition model. Whether through hedges and volumetric production payments to protect economics or joint ventures to complete the transaction, Apache continually finds a way to get the deal done.

Major Acquisitions in Apache's 5th Decade

Year	Acquisition	$ IN MILLIONS
1995	*Dekalb*	304
	Texaco	567
	Aquila	201
1996	*Phoenix*	334
1997	*Mobil/Ampolex*	300
1999	*Shell Offshore*	716
	Shell Canada	493
2000	*Collins & Ware*	321
	Occidental	304
	Crescendo	222
	Phillips (Zama)	490
2001	*Fletcher Challenge*	677
	Repsol	410
2002	*South Louisiana*	260
2003	*BP-U.K.*	630
	BP-G.O.M.	599
	Shell Offshore	200
2004	*Exxon/Mobil*	385
	Anadarko	537



As a purchaser of oil and gas properties, today's Apache dates to the mid-1980s when the company and its subsidiaries spent $1 billion on acquisitions from Dow Chemical, Davis Oil and Occidental Petroleum. But only with corporate restructuring following the rollup of Apache Petroleum and the concurrent withdrawal from the program business did the "exploit" side of the coin gain recognition. Mick Merelli and Steve Farris applied it first on the Occidental properties and, more notably, on the 1991 MW Petroleum acquisition from Amoco.

Oxy and MW made Apache a billion-dollar company. "Acquire and exploit," in the form of near-countless transactions from majors and independents alike, has multiplied that more than ten-fold.

1991 MW Petroleum Acquisition

The MW Petroleum acquisition from Amoco is easily one of the most defining events in Apache's history:

- At $545 million, it doubled the size of the company;
- It brought relative balance to Apache's oil and gas reserves, a strategic equilibrium that acts as a partial hedge against price volatility;
- It shifted the center of Apache's geographical mass to the Gulf Coast and precipitated the move of Denver headquarters to Houston;
- It brought Apache a position in the Permian Basin of West Texas;
- It demonstrated that Apache, as a growing independent, could do business with the majors, opening the door to every large acquisition since;
- It gave life to the strategy of "acquire and exploit";
- It underwrote Apache's domestic growth from the early- to the mid-1990s and continues to be a valuable contributor to the bottom line.

Apache's reserves historically had been heavily weighted toward natural gas, with the ratio of gas to oil at year-end 1990 at approximately 80:20. Given the price volatility of natural gas, Apache's revenue stream was at times unstable. With a balanced reserve mix, the company could more easily survive inevitable price swings and stabilize its ability to service the debt that would arise within its budding, acquisition-driven growth strategy.

MW presented such an opportunity, but not without a high degree of sweat equity going into the negotiations. Amoco doubted the ability of the relatively small independent to perform and the initial asking price of $1 billion was perhaps beyond Apache's ability to finance. When it became clear that

MW	Investment ($Millions except percentages)	MMboe	$Cost/Boe
As of 7/1/91	545.5	111.1	4.91
Initial Asset Sales	(98.9)	(22.0)	4.50
Retained Assets	446.6	89.1	5.01
Production	(1,128.9)	(108.2)	10.43
Asset Sales	(174.1)	(36.5)	4.77
Capital Investment	358.1	131.0	2.73
As of 12/31/03	(498.4)	75.4	(6.61)
Investment Returned	191%		
Remaining Reserves		68%	

most potential buyers were not displaying interest, Apache proposed that the sales package be reduced to only those properties that complemented Apache's existing acreage. Amoco balked.

Further complicating the negotiations, oil prices during the period almost doubled from the mid-teens in response to the 1991 Gulf War. Amoco, as the seller, was naturally more optimistic about future pricing trends than Apache as the buyer.

The breakthrough came when the two sides negotiated a price-support agreement that protected Apache on the downside in return for guaranteeing Amoco a portion of the upside. In Raymond Plank's words, the mechanism "*possessed the elements of current formal hedging and derivative practices ... before current exchanges existed.*" So innovative was the structure that it became a case study written by the Harvard Business School entitled "Bridging the Gap Between Buyer and Seller: MW Petroleum Corporation."

As of December 31, 2003, the MW acquisition has returned 191 percent of Apache's original investment while still carrying 68 percent of the original reserves on the books.

The 1986 Oxy acquisition taught the post-tax-reform Apache how to walk. MW taught it how to run.

1992 Pulling Up Stakes ... Again: The Move to Houston

In 1992 Apache completed its five-year stay in Denver and moved the company to its present headquarters in Houston.

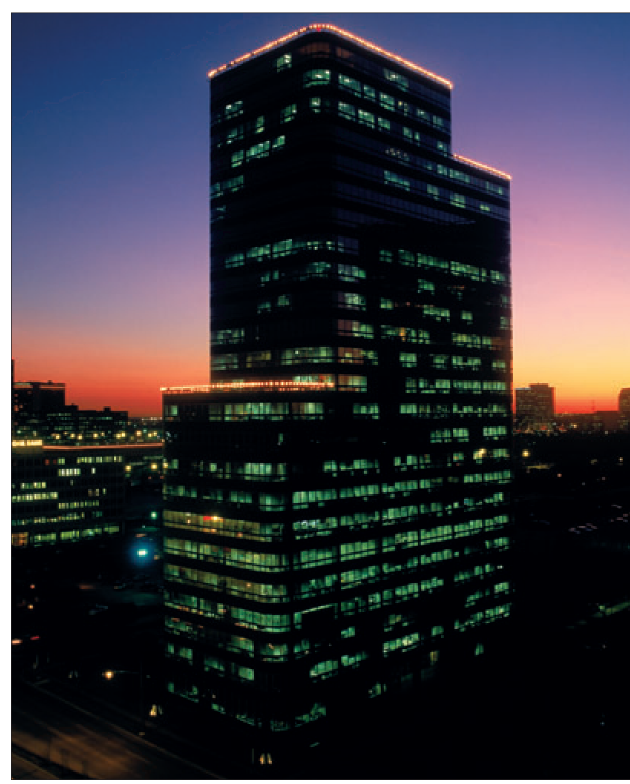
The catalyst for the relocation was Apache's 1991 acquisition of MW Petroleum from Amoco. That transaction shifted the center of Apache's geographical mass from the Mid-continent to the Gulf Coast.

The logic for the move was simple:

- The growing, deal-making independent needed to be where the action was;
- The restructured exploration and production company needed to avail itself of Houston's talented pool of oil and gas personnel;
- The survivor of industry consolidation saw advantages in the U.S. oil and gas industry's coalescence around Houston;
- The embryonic international independent saw opportunities in Houston's growing role as the world oil capital.

The Apache that arrived in Houston that summer had taken the better part of 40 years to accumulate $1.2 billion in assets. The Apache of 2004, with 12 years in Houston and 50 years in business, has grown more than tenfold.

That success reflects the oft-seen bumper sticker: "I wasn't born in Texas but I got here as quickly as I could!" Amen.



Houston headquarters: One Post Oak Central

1992 Roberto Acquisition

Roberto	Investment ($Millions except percentages)	MMboe	$Cost/Boe
As of 11/1/92	58.0	13.7	4.23
Production	(194.5)	(15.5)	12.55
Capital Investment	31.3	3.7	8.46
As of 12/31/03	(105.2)	2.0	(52.60)
Investment Returned	281%		
Remaining Reserves		15%	

None of the company's larger acquisitions has ever been bought at auction. Almost all are the result of careful negotiation. Every now and then, however, something falls out of the sky and lands squarely on Apache. Such is the Roberto acquisition.

The Roberto field, comprising Matagorda Island Blocks 681 and 682 in federal waters of the Gulf of Mexico offshore Texas, was one of the original Shell Joint Venture prospects. Apache and its affiliates held an approximate eight percent interest in the field. The balance was held by Shell.

In September 1992, Shell notified Apache that it intended to sell its interest in Roberto to a third party for $58 million. Under the terms of the governing joint-venture agreement, Apache had 30 days to make a decision: It could exercise its preferential right and match the offer; or it could waive the right and allow the third-party transaction to proceed.

Apache's technical teams did their homework and, before the 30-day period expired, chose to exercise the preferential right to purchase just as commodity prices began to spike. An agreement with Shell was signed in October and the acquisition closed that November. With this one transaction, Apache doubled its offshore gas production, added reserves of 73 Bcf of gas and 158 Mbbls of condensate and captured a marvelous rate of return.

Through the end of 2003, exploitation has returned 281 percent of the original investment.

Apache's core-area concept came to life with the 1993 Hadson Energy Resources acquisition in Australia.

In their simplest form, core areas involve the development of local expertise with centralized management and decentralized decision-making. Modeled after Apache's lengthy experience in the Anadarko Basin of Texas and Oklahoma, they are the outgrowth of the company's early international efforts represented by random, one-well shots that, if successful, left little room for expansion and growth.

Apache has core areas in the United States, Canada, Australia, Egypt and the United Kingdom North Sea. Conceptually, they give Apache portfolio diversity in terms of exposure to geology, geography, hydrocarbons (oil or gas) and political risk. Some present high-risk, high-reward exploration opportunities with associated potential for long-term growth. Others feed that growth with low-risk, high-rate-of-return production and cash flow. Some are gas-prone, some oil-, others both. All have the "running room" of large acreage positions and all combine to help weather market vagaries in support of Apache's long-term growth objectives.

1993 Core Areas

Country	Reserves (MMboe) 12/31/03	%
United States	727.6	44
Canada	436.0	26
Australia	167.0	10
Egypt	165.0	10
UK North Sea	148.5	9
Non-Core	12.4	1
Total	**1,656.5**	

1993 Hadson Acquisition

The Hadson Energy Resources acquisition made Apache one of the largest leaseholders offshore Western Australia and elevated Australia to a core area.

Varanus Island

Recognizing a favorable geologic, geographic, political and fiscal opportunity after several learning-curve experiences, Apache first entered the Carnarvon Basin offshore Western Australia in 1991 with the acquisition of a small, non-operated interest near Airlie Island. The subsidiary's year-end reserves approximated 600,000 barrels of oil (one-third of one percent of the parent's reserves). A two-year payout with no noticeable decline in original reserves caught management's eye, as did the long-term growth potential of the under-explored basin, in size and maturity comparing favorably to the Gulf of Mexico in the 1950s.

Management also noticed that Apache had no operational control and no gas sales contracts against which to book most of the new reserves it was finding. The hunt for additional properties with associated operations, marketing infrastructure and local expertise began in earnest. When Hadson Corporation suggested that Apache purchase its Australian subsidiary, the proposal fell on receptive ears.

The $98 million Hadson transaction brought Apache its Perth office and staff, operations in eight fields collectively known as Harriet, and control of the strategically important Varanus Island production, processing and marketing hub. Overnight, Apache had equivalent year-end reserves in Australia of almost 12 million barrels of oil (five percent of a growing Apache), 3.3 million net undeveloped acres and control over the exploration and development of its massive Carnarvon Basin acreage.

The Hadson acquisition also marked the end of Apache's previously random, one-shot approach to international expansion. Apache had become a serious and determined international player.

1994 Hall Houston Acquisition

Hall Houston	Investment ($Millions except percentages)	MMboe	$Cost/Boe
As of 8/1/93	$117.2	19.1	$6.14
Strategic Acquisitions	54.1	8.9	6.08
Production	(494.2)	(38.2)	12.94
Asset Sales	(12.7)	(2.6)	4.88
Capital Investment	158.1	16.6	9.52
As of 12/31/03	($177.5)	3.7	(47.97)
Investment Returned	251%		
Remaining Original Reserves		19%	

The Hall Houston acquisition, doubling Apache's Gulf of Mexico gas production and increasing the company's offshore gas reserves by two-thirds, or 104 Bcf, certainly had positive operational impact. What made it defining, however, was the fashion in which it came about and what that said about Apache's culture, spirit and ever developing sense of getting things done.

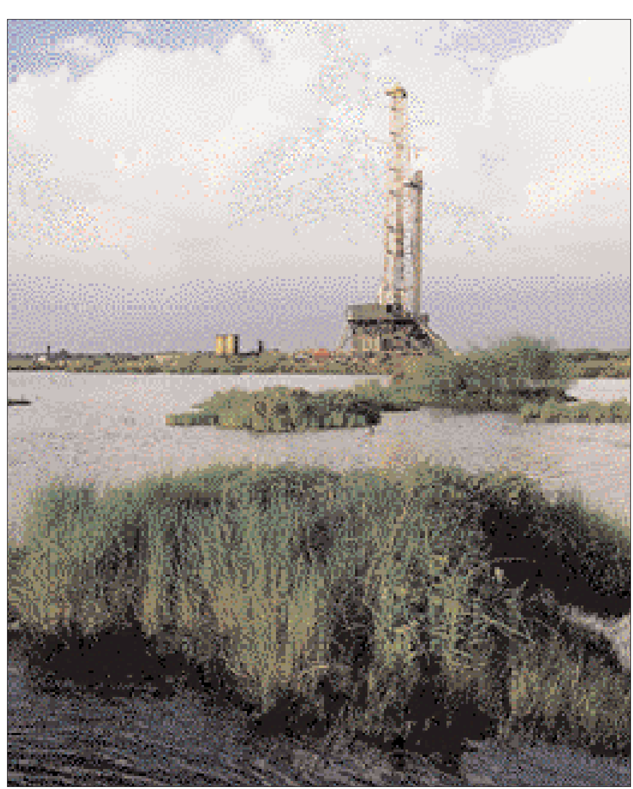
More often than not, Apache is the hunter when it comes to large acquisitions. In this case, and as in the earlier Roberto acquisition, the quarry found Apache.

Jim Pavlich, then Apache's Gulf Coast drilling manager, had lunch one day with an offshore drilling contractor to discuss the timing of an Apache job. The contractor told Jim to expect a delay as Hall Houston was going to use the rig to develop one of its recent discoveries. He also mentioned that the discovery itself might be for sale.

Pavlich went to work. "*I hustled back to the main office with the news and, within a day, Jim Bauman (vice president and head of Apache's acquisition team at the time) had his evaluation team studying the properties. Two days after that, back came Bauman saying that the whole outfit might be for sale and that he and Steve Farris would be meeting with Hall Houston to see if they might be able to work something out. Hey, within a month, it was a done deal.*"

So closely identified with the transaction, Hall Houston is Pavlich's legacy to Apache (beyond his marvelous sense of humor). Apache has recovered 251 percent of the original investment with 20 percent of the original reserves still in place.

1995 Texaco Acquisition



The 1995 Texaco acquisition, Apache's then-largest at $567 million, added 110 million barrels of oil equivalent and increased Apache's reserves by 40 percent at an average cost of $5.18 per barrel.

The acquisition encompassed 315 oil and gas fields in the Permian Basin, the Texas-Louisiana Gulf Coast, western Oklahoma, East Texas, the Rocky Mountains and the Gulf of Mexico. By year-end 2003, Apache not only had recovered all of its original investment, it also had grown the reserves: Volumes equal to 115 percent of the original estimates remained on the company's books. Oil and gas production have exceeded the original forecast by six percent and 30 percent, respectively, with operating expenses lower than those originally projected.

An interesting side note: Apache is nothing if not fiscally disciplined, maintaining the highest credit rating in its sector. To accomplish the Texaco transaction, the company had to stretch, running its debt over 60 percent of capitalization. In characteristic fashion, Raymond Plank publicly defined a challenge: "*Apache will take its debt-to-capitalization ratio down below 50 percent by year-end 1995.*"

Apache achieved the objective, ending the year with a debt-to-cap ratio of 49.6 percent. At year-end 2003 it was below 30 percent.

1995 Dekalb Merger

Although gradually diversifying away from oil and gas in the 1960s, Apache spent the better part of that decade establishing a Canadian oil and gas subsidiary. Operations in Alberta and Saskatchewan were guided from a regional office in Calgary. When in the 1970s Canada's National Energy Policy began to place restrictions on foreign ownership of upstream assets, Apache withdrew from Canada.

By the early 1990s, management felt the two previously distinct natural gas markets in North America were converging, creating opportunity for those willing to risk investment in Canada's large, undeveloped reserves.

Applying the lessons learned in developing its Australian subsidiary, Apache went in search of Canadian operations and the running room that would come from establishing a sizable acreage position. Dekalb Energy Canada Ltd., with 60 MMBoe of reserves, 150,000 net acres and $60 million in debt made burdensome by low commodity prices, simultaneously sought a buyer. Negotiations led to an early-1995 merger.

The Dekalb transaction marked the return of Apache to Canada after an almost 25-year absence, the elevation of Canada to one of the company's core areas and the redeployment of assets as the company exited the higher-cost Rocky Mountain region.

The newly acquired Canadian assets underscored Apache's belief that the natural gas market would become more North American than domestic, that diversification in selected basins globally enhanced the potential for future growth and that a position in Canada's Western Sedimentary

Basin represented the greatest opportunity to capitalize on anticipated North American gas supply shortages and the Lower 48's voracious energy appetite.

Strategically, Apache was ahead of the rush of American energy companies into Canada. Spending the period from 1995 to 1998 reacquainting itself with the Canadian market, Apache commenced in 1999 a three-year string of acquisitions from Shell, Phillips and Fletcher Challenge that multiplied the original Dekalb reserves nearly five-fold and firmly established Apache as a serious north-of-the-border player.

1996 First $100 Million Year

Apache's earnings crossed the $100 million threshold for the first time in 1996. Reaching $121.4 million, the achievement nearly tripled 1992's previous high of $47.8 million.

Apache earned $12,000 in its first full year of operations. In 1988, its very survival was predicated upon reaching a stated goal of $5 million in net income after two consecutive years of losses. Earnings that year reached $5.4 million.

The 1996 milestone, six times greater than 1995 earnings, was a function of both environmental and strategic factors. Average oil and natural gas prices from the preceding year were up 22 percent and 29 percent, respectively, to $20.84 per barrel and $2.02 per Mcf. They helped produce an increase of $180 million in oil and gas revenue.

Gathering, processing and marketing proceeds jumped 47 percent to $143 million, a $46 million gain over the previous year. Much of the increase came from the sale of three-quarters of Apache's net production under improved spot-market contracts. The balance arose from term contracts at premium prices.

It took Apache 42 years to achieve this earnings milestone. It has done so on a monthly basis several times since.

It took Apache 42 years to achieve this earnings milestone. It has done so on a monthly basis several times since.

1996 Phoenix Merger

Apache entered Egypt in 1994 by acquiring a 25 percent non-operated interest in the Western Desert's Qarun Concession alongside the Phoenix Resource Companies. While early discoveries, particularly at Qarun, were encouraging, Apache in Egypt had no reserves and no production at year-end 1995.

Eager to step up the pace of its Egyptian operations and increase its exposure to the country's multiple producing basins, Apache proposed a merger in which Phoenix would become a wholly owned subsidiary. The proposal was approved by Phoenix shareholders in May 1996.

Through the merger, Apache tripled its interest in the Qarun Concession and added a 40 percent interest in the Western Desert's prolific Khalda Concession. By year-end 1996, the company held over 6 million net acres in Egypt, had booked reserves of nearly 59 MMBoe and had production of 60,000 barrels of oil per day.

The merger with Phoenix elevated Egypt to the status of core area and set the stage for future expansion that today makes Egypt one of the primary engines of Apache's organic growth.

1997 Mobil Ampolex Acquisition

The Mobil Ampolex acquisition was the second of two important chapters in Apache's Australian story. Exploiting the leasehold acquired in 1993 from Hadson Energy Resources with characteristic urgency, Apache had grown its Australian reserves to almost 32 MMBoe when opportunity again came knocking. In the $300 million Mobil Ampolex transaction of 1997, the company increased its Harriet and Varanus interests from 22.5 percent to 47.5 percent and acquired equivalent reserves of 32 MMBbls, doubling its Australian reserve position.

With tactical acquisitions from Novus and Hardy in 1998, Apache completed the expansion of Harriet through acquisition, raising its interest to 68.5 percent. By the end of that year, the Australian subsidiary had reserves of 133 million equivalent barrels. That was 22 percent of the company's worldwide reserves and more than the entire company held only eight years earlier.

Varanus Island Gas Plant

1997 S&P 500

Trading on the NYSE began in 1969, simultaneously bestowing credibility on the company and increased liquidity on investors.

Upon the company's founding, one of Raymond Plank's long-term goals for Apache was to obtain listing on the New York Stock Exchange. Trading on the NYSE began in 1969, simultaneously bestowing credibility on the company and increased liquidity on investors.

Over the next 30 years Apache shed itself of its non-oil-and-gas assets, created Apexco and Apache Petroleum Company (both of which were listed on the Big Board), devised innovative financings, restructured, went international before it became the thing to do, and achieved critical mass. It demonstrated a strong and relentless work ethic and an ability to adapt, innovate, survive and thrive through the unique challenges posed by repeated industry cycles.

All earned acknowledgment when, on July 22, 1997, Apache was added to the S&P 500, becoming one of "the leading companies in the leading industries of the U.S. economy."

It was an early indicator of greater things to come.

1998 The Fund for Teachers

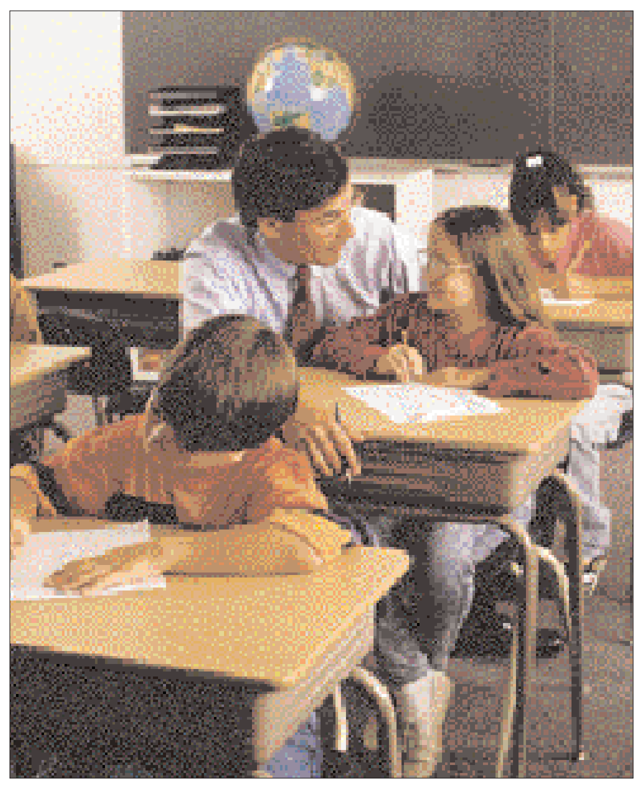
As a result of the strong, lasting and positive influence that teachers had on Raymond Plank's life, he started a program in his hometown of Minneapolis to provide teachers with opportunities for summer sabbaticals — self-designed programs of summer learning and exploration. He endowed the program with $1 million.

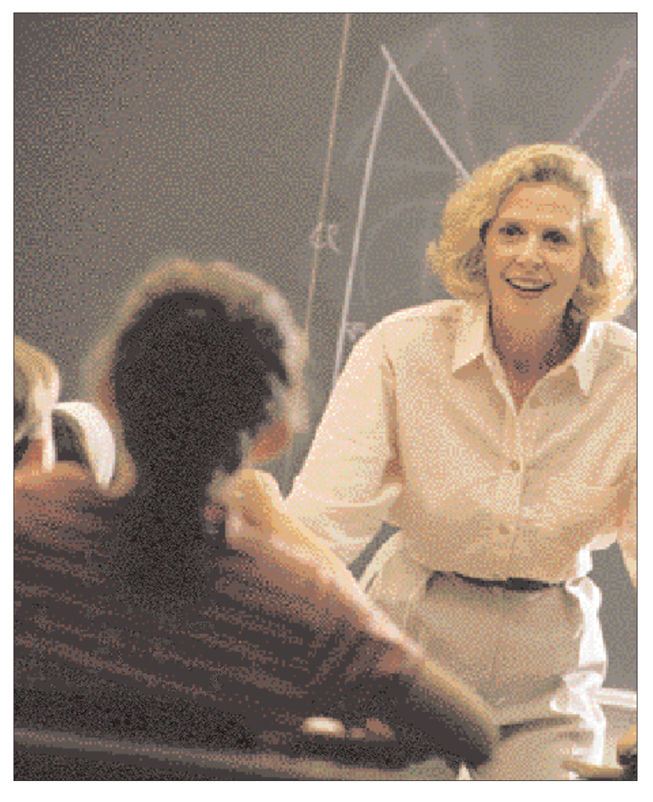
Superintendents at public and independent schools believed that the program would help teachers through the recognition, respect and renewal that could result. They shared Plank's belief that the teachers' personal growth and outreach to their pupils would improve the interactive process. That pilot program has grown into a public foundation, the Fund for Teachers (FFT).

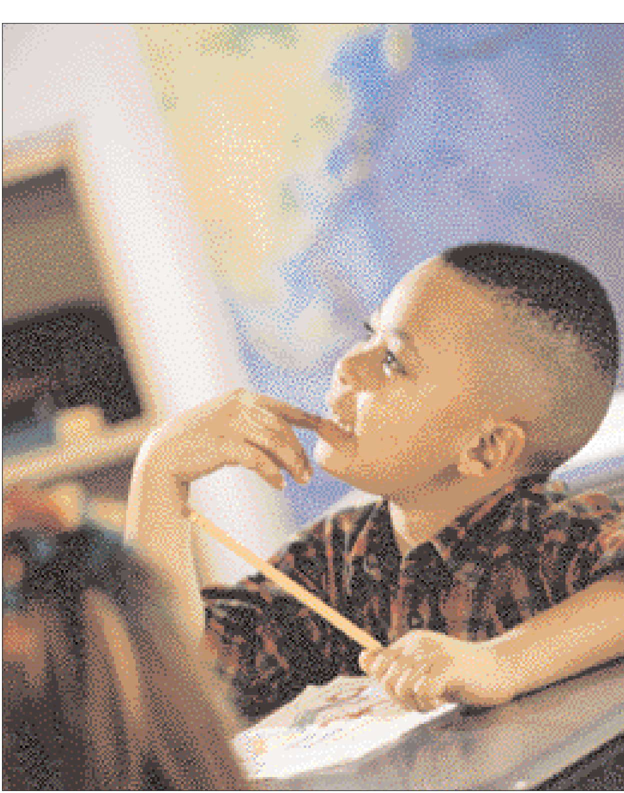
FFT is a unique foundation whose mission is to enrich the lives of teachers and students alike. Making a difference one teacher at a time, FFT provides funds for direct grants to support summer learning opportunities of their own design. Between 1998 and 2003, 567 Fellows in seven cities — Denver, Houston, Minneapolis, New York, Oakland, St. Paul and Tulsa — received funding.

In 2004, the program expanded, awarding grants of $1.4 million to 444 teachers from 224 different schools. Included for the first time were recipients in Boston and in rural Colorado and Oklahoma. In addition, FFT partnered with Expeditionary Learning Outward Bound, awarding 44 grants in 15 states, Washington, D.C., and Puerto Rico.

There are few, if any, large-scale national initiatives that address the professional growth and renewal of teachers.







With private and non-profit sector funding, FFT bypasses district and union bureaucracies and adds value in the classroom without additional costs to schools or individual teachers.

Teacher testimonials, as well as comments from supervisors and peers, provide proof that the Fund for Teachers is achieving Plank's goal of enriching teachers' lives in ways that impact students on a daily basis. Many have absorbed or acquired in-depth, hands-on experience that can be used in the classroom over many years. Some have found that simply returning to the role of student helps them to better motivate their students to value learning, adventure and discovery.

In 2003, Apache Corporation honored Raymond Plank and the FFT by making a pledge of $15 million over three years to facilitate national growth and augment the scope of the foundation.

1999 Shell Gulf of Mexico Acquisition

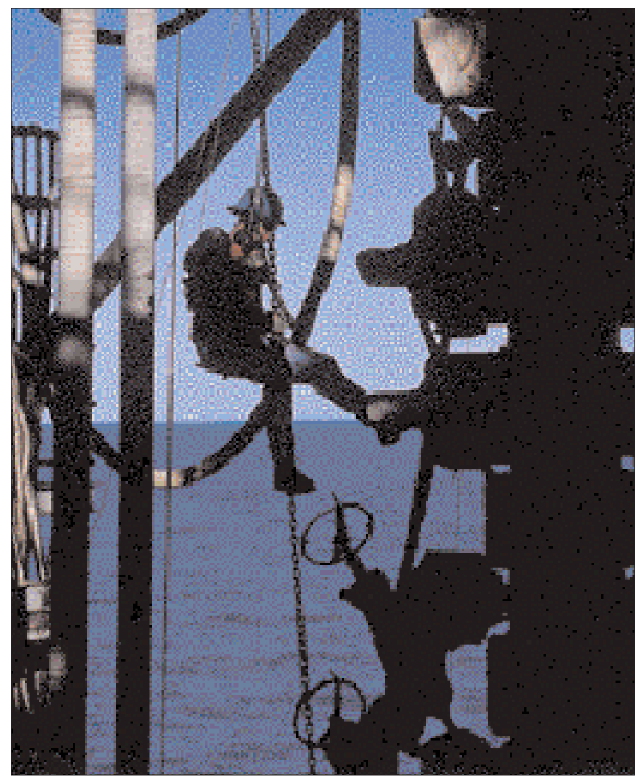
Transformative acquisitions are few and far between. Oxy in 1986 and MW Petroleum in 1991 were the first and second to earn the description. The 1999 Gulf of Mexico transaction with Shell was the third.

In 1995, Texaco came close, increasing Apache's reserves by 60 percent. The DeKalb merger the same year returned Apache to Canada. The Phoenix merger in Egypt in 1996 assumed company-wide importance over time and the Hadson/Mobil/Ampolex transactions in the middle 1990s consolidated Apache's operations around the strategically important Varanus Island Hub offshore Western Australia. But by early 1999, it had been years since anything really "big" had happened.

Jeff Bender, presently Apache's vice president of human resources, had once not so facetiously described the Apache culture: "*We don't idle well!*" He knew that Apache was good at blocking and tackling, tending its business and furrowing for opportunity. He also knew that Apache was not at its best unless it was firing on all cylinders while facing challenging and significant opportunity.

Raymond Plank and Steve Farris sensed as much. They also knew that with commodity prices floundering near $2 per Mcf and $13 per barrel, the time was ripe for Apache's acquisition strategy of buying in a downturn and betting on future recovery.

Aware that Shell was preparing a package of properties to put up for auction, Plank and Farris sought the opportunity for a negotiated transaction. Months of discussions followed, made possible in part by the unique working relationship forged between the two parties through the still-active Shell Joint Venture.



1999 Shell GOM	Investment ($Millions except percentages)	MMboe	$Cost/Boe
As of 5/16/1999	716.1	123.0	5.82
Production	(1,512.4)	(68.4)	22.11
Capital Investment	594.0	25.9	22.93
As of 12/31/03	(202.3)	80.6	(2.51)
Investment Returned	128%		
Remaining Reserves		66%	

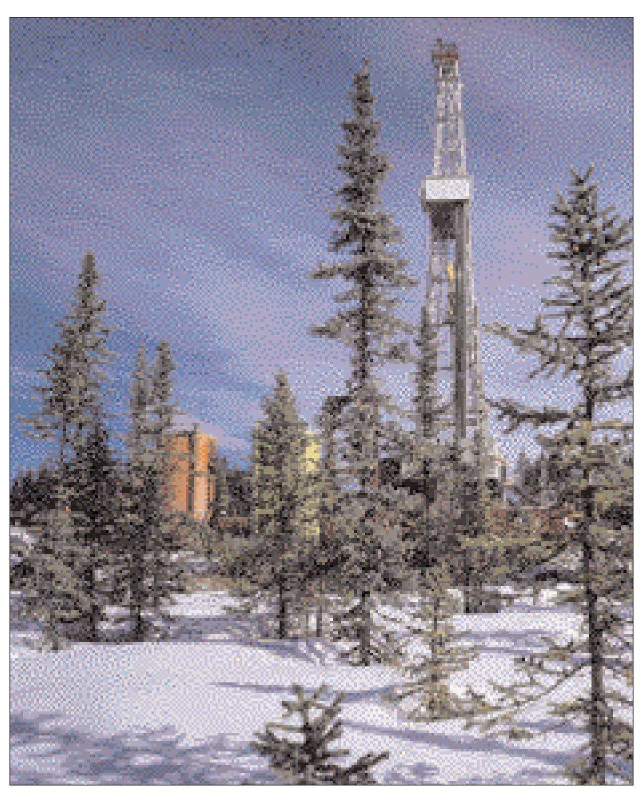
Apache announced the transaction on April 29, 1999, and immediately saw its share price appreciate over 10 percent. For $716 million and $31 million in stock, Apache acquired 22 fields, 123 MMBoe and average daily production of 25,000 barrels of oil and 125 MMcf of natural gas. Of the largest transaction up to that point in Apache's history, Raymond Plank said: "*Ultimate shareholder reward is predicated upon the value we seek to add in a volatile pricing environment. This will be a transforming event for Apache.*"

His prediction was accurate. In four years, the 1999 Shell acquisition has performed better than the MW acquisition has done in 12 years. It also proved to be a profitable catalyst: It was the first of four Gulf of Mexico acquisitions through which Apache became the largest held-by-production leaseholder and fourth-largest producer on the Continental Shelf; it was the first of four negotiated transactions with Shell for properties in the Gulf and in Canada; it was the first in a series of 11 transactions through 2003 on which Apache spent over $5 billion solidifying, and in one case establishing, each of the company's present core areas.

1999 Canadian Expansion

With atypical patience, Apache waited four years to augment its 1995 return to Canada. With very typical urgency, it made up for lost time, announcing three acquisitions over 18 months that increased the region's reserves five-fold to 354 MMBoe from 68 MMBoe.

In November 1999, Apache acquired reserves of 87 MMBoe in British Columbia, Alberta and Saskatchewan from Shell Canada Limited for $524 million. It had been only six months since Apache closed its transformational Gulf of Mexico acquisition with Shell's U.S. subsidiary.



In December 2000, Apache acquired reserves of 72 MMBoe in the Zama area of northern Alberta from the Canadian affiliate of Phillips Petroleum. Included were several properties once owned by the Canadian oil-and-gas drilling funds Apache formed in the 1960s.

In March 2001, Apache acquired 121 MMBoe in properties from Fletcher Challenge Energy which, as in the Shell transaction, were spread across British Columbia, Alberta and Saskatchewan. Apache and Shell, in their third recent transaction, jointly made the acquisition, with Shell keeping the Fletcher Challenge properties in New Zealand and Brunei.

Apache President Steve Farris had worked hard to develop a relationship with Shell, which paid off in earlier acquisitions from the major in Canada and the Gulf of Mexico. Fletcher Challenge was a significant development in that Apache partnered with Shell to acquire assets from a third party.

Counting Dekalb and the three subsequent Canadian transactions, Apache had acquired 338 MMBoe at an average price of $5.66 per barrel. At year-end 2001, Apache Canada had reserves of 354 MMBoe on its books, a level Apache's U.S. parent did not reach until its 45th year.

2001 Repsol Acquisition

The $410 million acquisition in 2001 from Repsol YPF, the Spanish national oil company, "*made Apache the largest producer of liquid hydrocarbons in Egypt's Western Desert and the second-largest producer of natural gas. It more than doubled Apache's year-end 2000 Egyptian reserves of 68 MMBoe and added significant upside potential in terms of exploration, exploitation and infrastructure enhancement opportunities,*" said Raymond Plank, Apache's chairman and founder.

With the acquisition, Apache became the operator of seven Western Desert concessions, the most significant of which was and is the prolific Khalda/Khalda Offset. With increased contractor interests and the activation of Apache's aggressive, proactive approach to operations, the company also became Egypt's largest U.S. investor. With 107 new wells in 2003, the annual count of wells drilled has more than doubled. In addition, two exploratory programs (West Med and Qasr) on Repsol acreage have resulted in estimated recoverable reserves of five trillion to seven trillion cubic feet of natural gas, positioning Apache to supply much of the double-digit annual growth in Egyptian gas demand.

In the three years since the acquisition closed, Apache has recovered almost half its investment and replaced 150 percent of the reserves it has produced.

The Repsol acquisition was not merely defining. It was a transforming event for Apache's Egyptian subsidiary.

2002 West Mediterranean Discovery

Between May and December of 2002, Apache Corporation drilled its first deepwater wells, successfully exploring its West Mediterranean Concession offshore Egypt. Four exploratory wells and one appraisal well, drilled at water depths between 2,300 feet and 3,500 feet, provided sufficient evidence of 3 trillion cubic feet of potential natural gas reserves, allowing Apache and its partners to commence negotiations with the Egyptian government for the sales agreement necessary to begin development.

Of particular significance was the fourth exploratory well, the El King - 1X, which found not only significant gas reserves in the primary Miocene-age formation and the secondary Pliocene objective, but also the first Miocene deepwater oil anywhere in the Nile Delta. The discovery invigorated the play's deepwater oil exploration.

A Memorandum of Understanding with the Egyptian government for a sales agreement and a plan of development was signed in December 2003. Total revenue to all parties, net of projected development costs, will be approximately $6 billion.

Mike Harris, Apache's director of worldwide drilling, described the concession: "*The West Mediterranean block has the best exploration potential of any play in Apache's world-wide inventory. Furthermore, deepwater drilling in this area is far less expensive than in the Gulf of Mexico and, because of its proximity to shore, development costs will be lower. This has proven to be a wonderful opportunity for Apache to cut its teeth and develop its expertise on deepwater operations.*"

When it rains, it pours. Seven months later, Apache drilled the Qasr - 1X well in Egypt's Western Desert. By itself, that well established reserve potential equal to the five wells drilled at West Med. Apache's explorationists in Egypt were on a roll!

2003 BP North Sea Acquisition

Effective January 1, 2003, Apache acquired from BP the Forties Field, the largest oil discovery ever in the United Kingdom North Sea. With the opening of an office in Aberdeen, Scotland, the acquisition established Apache's fourth international core area.

Adding 148 million barrels at a cost of $630 million, the field immediately became Apache's largest single asset. Discovered by BP in 1970 and productive since 1975, Forties still ranks eighth in production and remaining reserves after having produced some 2.5 billion barrels.

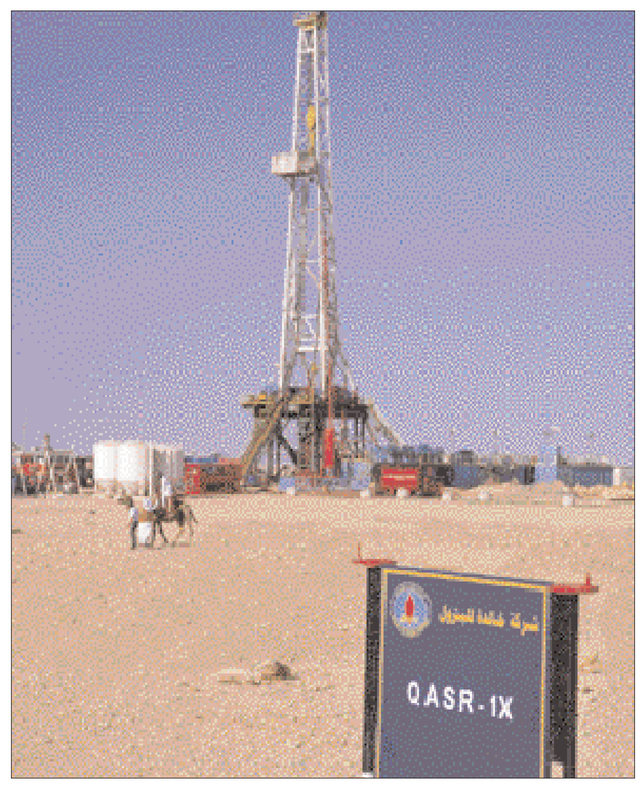
Apache had been considering UK North Sea opportunities for years and, in late 2002, learned that BP intended to sell certain assets in order to redeploy capital elsewhere in search of greater exploratory upside. BP sought to take the properties to auction but was hampered by timing constraints that gave Apache's normal sense of urgency new meaning. Only with assurances of Apache's resolve to close a transaction on BP's schedule did the negotiations proceed. Normal holiday festivities at year-end were but a figment of the negotiating teams' imagination.

Apache spent 2003 conducting required maintenance on the five Forties platforms in order to stabilize daily production before commencing its drilling program in early 2004. One of the first new wells produced oil at a daily rate of 4,200 barrels.

In many respects, the North Sea today offers opportunities to Apache similar to those offered by the Gulf of Mexico in the 1980s. It is a relatively mature hydrocarbon-producing basin in which the major operators find it increasingly difficult to meet their return targets. It is precisely the type of geographic and geologic opportunity on which Apache can, and does, capitalize.

2003 Qasr Discovery

The Qasr - 1X is the largest onshore gas discovery in the company's history. Apache operates the well and the field with a 100 percent contractor interest and there's already an executed, 25-year gas sales contract. What more needs to be said?



Located in the south-central portion of Egypt's Khalda Concession, the well was drilled in mid-2003. Logs identified a 670-foot hydrocarbon column. A test of two intervals flowed at a combined rate of 52 million cubic feet of natural gas and 2,688 barrels of condensate per day. A subsequent appraisal well identified a 707-foot column.

Reserves for the 13,000-acre structure, after the drilling of only four wells, are estimated to be 2 trillion to 3 trillion cubic feet of natural gas and 20 million to 70 million barrels of condensate.

Reacting quickly to meet rising Egyptian demand for natural gas, Apache executed in early 2004 a gas sales agreement through which it committed to deliver into the domestic market 300 million cubic feet per day through 2024. Production is expected to ramp up by mid-2005.

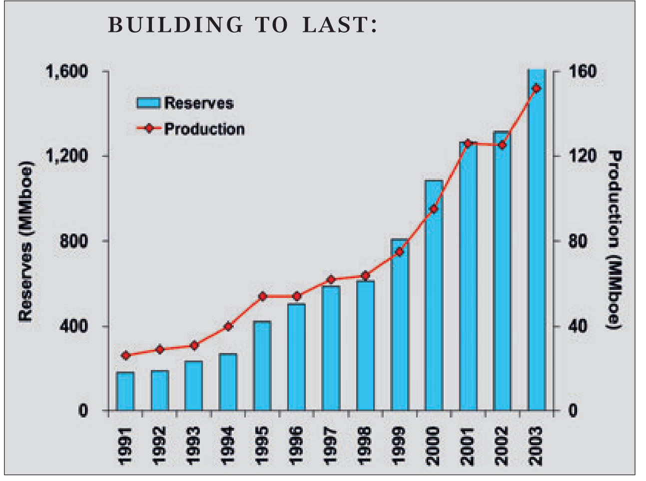
"*Qasr is the most significant discovery in the Western Desert in the last decade and perhaps the most significant in Apache's history,*" said Steve Farris, Apache chief executive officer and president. "*It establishes the Western Desert as an important hydrocarbon province well into the 21st century and provides energy for Egypt's further economic development.*"

And it's not all bad for Apache's further economic development either!

2003 Record Earnings, Production, Reserves

Closing the books on 2003, Apache reported its best year ever:

- Record earnings of $1.1 billion;
- Record production of 417,400 Boe per day;
- Record reserves of 1.7 Boe equivalent.



"Strong commodity prices are only part of the story of our 2003 results," said Bob Dye, vice president of investor relations. *"In addition to earning over $1 billion, production increased 22 percent and worldwide reserves increased 26 percent. We replaced 330 percent of our production through a combination of strategic acquisitions and outstanding drilling success. In a year in which we added over half a billion barrels of oil equivalent on $3 billion invested, we reduced Apache's debt to 26 percent of capitalization."*

Average worldwide oil and gas prices stayed strong for the fourth consecutive year, supporting Apache's premise that the energy industry is an excellent long-term investment.

2003 Evolution of Culture

"Hustle" evolved over 40-plus years to "a sense of urgency." Both describe the culture. "We don't idle well" describes the mood.

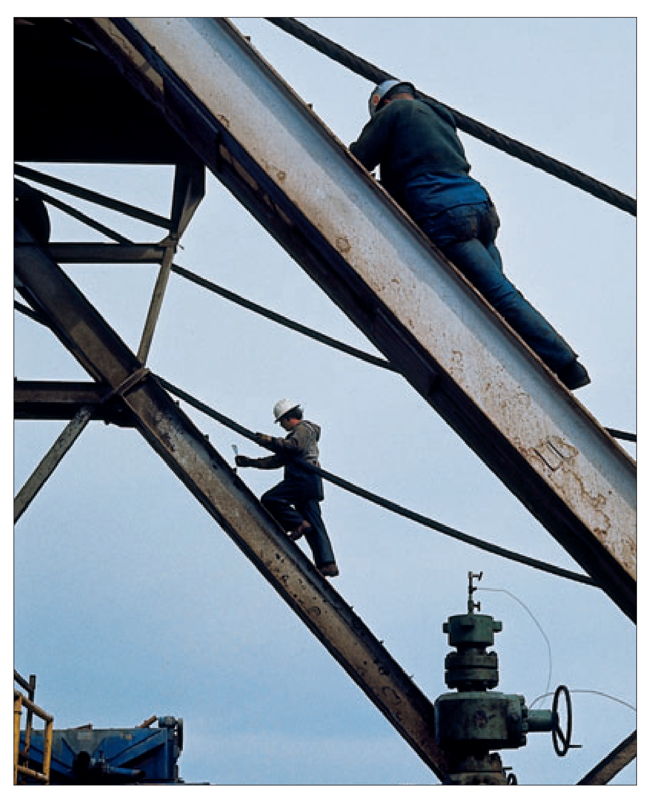
By definition, a company successful over time has good people.

The best estimates suggest that Apache has had between 7,000 and 8,000 employees in its 50-year history. Of the approximately 2,500 on the payroll late in 2004, there are less than 20 who have been with the company since the 1970s. Founder Raymond Plank is the sole survivor of the 1950s and one of but a handful who remembers what winter in Minnesota was all about (besides burning lots of natural gas).

As diversified as it once was, Apache always has had its fingers in oil and gas. It diversified when energy could not ensure survival and it refocused when energy finally displayed long-term potential. Players came and players went. Headquarters left Minneapolis for Denver and then Denver for Houston. And yet the company thrived.

All of which suggests that Apache has not only had good people all the time, it's had the right people at the right time.

Apaches make countless presentations to the investment community every year and usually take a stab at defining the culture behind the success. Listening to them, one might conclude that each is blindfolded and holding onto a different part of the elephant's anatomy. Each is precisely correct in his or her evaluation, but none is able to accurately describe the whole.



Their observations:

"If you wish to be challenged, come to Apache."

"For many of the people at Apache, it is difficult to distinguish work from play."

"Come up with a good idea and you can get an audience at the highest level in five minutes."

*"I have never heard anyone say, '*That's not my job.*'"*

"Apache may never be on someone's list of the top-10 places to work and not everyone thrives here. But, for those who do, there is no environment more challenging or rewarding. And there is definitely nowhere else they would rather be!"

"There is a sense of urgency to getting the job done."

"What's the objective? Cash flow like hell!"

"You are given a chance to demonstrate that you are capable and creative. It is up to you to provide the initiative and motivation."

"Apache's people run hard."

And, for those who know the exquisite satisfaction of hard work, little sleep, missed opportunity and great accomplishment: *"Apache is at once the best and worst place I have ever worked."*

And finally, there's a quote from an Apache consultant who was working with a small independent company to refine their systems and define their approach to the oil and gas business. He asked them what they wanted to be. *"We want to be like Apache,"* they said. He asked them what that meant. *"It's difficult to define but they've got the model we want."*

2004 Recognition

While Apache understandably has pride in reaching its 50th anniversary, there is more than one landmark worth celebrating. Apache made "the lists" of several publications. These rankings highlighted the most recent top-performing companies in a variety of ways.

Fortune: "Fortune 500"

At No. 413, Apache moved from the *Fortune 1000* to the *Fortune 500* for the first time. In addition, the company came in at 107th in profits; ninth in profits as a percentage of revenues; ninth in growth in revenues; 12th in total return to investors over the last five years; 114th in total return to investors over the decade; 120th in total return to investors in 2003; and 162nd in market value.

Apache also showed up among "Fastest-Growing Companies," "Most Profitable Companies" and "Best Investments."

Business Ethics "100 Best Corporate Citizens for 2004"

Apache was ranked No. 51 in the magazine's annual report. Identified firms were deemed to excel at serving seven stakeholder groups — shareholders, community, minorities and women, employees, environment, non-U.S. stakeholders and customers.

Forbes "The World's 2000 Leading Companies"

To reflect a more global economy, editors combined for the first time what had been published for 35 years as two separate rankings — a list of American companies and a separate list of foreign companies. In "The World's 2000 Leading Companies," Apache qualified at No. 441.

"As we have done since 1969, we measure corporate heft in four dimensions: sales, assets, profits and market value," *Forbes* reported. "Any one of these measures yields a lopsided list. A sales ranking gives too much importance to retailers; a profits ranking would make Time Warner disappear when it has a big write-off. Our list scores 2,000 global giants on a composite measure."

Apache was also among a group of 26 companies listed in the editors' "Best Managed Companies in America." Each came from a different industry but all had one thing in common. "They're all solid achievers in their respective industries. These companies exude excellence — in how they're managed and in financial performance."

Barron's "Barron's 500"

Apache made the grade at No. 74. The publication ranked the 500 largest companies in the United States and Canada, relying on a "calculation of cash-flow return on investment, the real cash returns on capital invested in a company stripped of the effects of inflation and accounting differences".

BusinessWeek "The BusinessWeek 50"

Apache earned No. 28 in this prestigious ranking. "It helps to be in the right market at the right time, but it certainly doesn't guarantee a spot in the *BusinessWeek 50*. The companies on this year's list rose above their rivals, often by learning to think like their customers."

To determine how companies in the Standard and Poor's 500 index compare to one another, *BusinessWeek* ranked all 500, using eight key criteria of financial success. Editors looked at growth in sales, profits, return to shareholders and performance over both one and three years, as well as profit margins and return on equity. Then they combined individual rankings and added a weighting for sales volume and long-term-debt-to-capitalization ratio to come up with the overall ranking.

Apache was noted for strategic acquisitions in the North Sea and Gulf of Mexico, drilling success, a 22 percent increase in production and record profitability.

GREY WOLF 16

NATURAL GAS MARKET REFORM — Apache's Perspective

Chairman and Chief Executive Officer Raymond Plank, center, speaks before the Energy and Air Quality Subcommittee of the House Committee on Energy and Commerce on February 13, 2002.

In various forms over its 50-year history, Apache has fought against structural inefficiencies in the market. The most recent and most visible example of such clashes has been that against the manipulation of the mega-marketers in order to bring integrity and transparency to the pricing of natural gas.

Obie O'Brien, Apache's director of governmental and regulatory affairs, has lived Apache's multi-year battle from its inception. His following summary of attempts to reform the natural gas markets highlights the ebb and flow of a much longer and as-yet-unfinished campaign.

Deregulation

Natural gas, the cleanest fossil fuel, has a checkered history. Originally thought of as a nuisance waste byproduct of crude oil production, it was disposed of by burning. How do you handle a colorless, odorless, flammable substance? How do you even get it to market? The answer to those two questions is: carefully and via pipelines. The nature of natural gas itself and its transportation through monopoly pipelines are such that it was a prime candidate for regulation. For decades, the wellhead price was capped by government at pennies per Mcf; the cost, accessibility and safety of pipelines were regulated as well.

The Energy Crisis of the 1970s and growing American dependence on foreign oil from the volatile Middle East, coupled with the ascendancy of free-market advocates in Congress and the presidency, led to deregulation. Wellhead natural gas prices were decontrolled in the late 1980s, followed by pipelines in 1992 with Federal Energy Regulatory Commission (FERC) Order 636.

Long-established relationships between producers, pipelines, utilities and consumers were turned on their head as the industry was deregulated. Emerging from the restructuring were the mega-marketeers. And the leading light of that new business model was a company known as Enron who, with Dynegy, American Electric Power, El Paso and others offered producers and consumers alike a new range of energy services that promised to be more efficient, reliable and economic than the old dynamic.

For decades, FERC (and its predecessor, the Federal Power Commission) was the sole pipeline regulator. After Order 636 and other initiatives to reduce economic regulation of the pipeline system were instituted, FERC focused on safety and environmental issues and turned other governance and operational issues over to state regulators.

It sounded great, but very quickly companies sought FERC approval to "spin down" pipelines to subsidiaries that were supposed to be regulated by state agencies ill-equipped or unwilling to provide oversight. In effect, FERC enabled the creation of unregulated monopolies that could issue take-it-or-leave-it offers and orders to both producers and consumers.

In the Oklahoma Panhandle, Enron began spinning down its pipeline systems. On New Year's Eve 1994, producers served by one of Enron's gathering systems in western Oklahoma were notified that the system was being spun down and assigned to another company subsidiary.

The unregulated subsidiary soon notified producers that the rules of the game had changed. All contracts to move producers' natural gas through the system were abrogated, and the pipeline announced that it would only handle volumes owned by Enron. That being said, the company was

willing to purchase natural gas at the wellhead, but only at 75 percent of the index price (more on the index system later). The offer was good for 30 days and it was not negotiable. If, at the end of that period, a producer had not signed the new contract, his natural gas would be shut out of the pipeline.

Producers quickly learned that there was nowhere to turn. The Oklahoma Corporation Commission did not have the authority to regulate pipelines and FERC no longer had any authority. Lawsuits were long and expensive propositions, especially if your wells were shut in and were not generating any cash flow.

The pipelines pressed their advantage: Connection fees doubled, tripled and then quadrupled; processing contracts were forced on some producers; and extra fees imposed on those whose natural gas didn't meet arbitrary quality standards.

Even larger producers such as Apache couldn't get a break; because natural gas production is so scattered throughout the producing states, no single producer could bring enough natural gas to market in a particular area to assert any kind of negotiating leverage.

It was almost the identical situation that farmers faced 100 years ago. They could tend the fields and produce the crops, but they were limited by how much produce they could get to market using farm trucks and carts. Real access to real markets required a larger-scale transportation system — railroads.

But the railroads, just like natural gas pipeline systems, didn't really compete with each other. They divided the country into zones of influence and exercised similar monopolistic and heavy-handed controls over access to markets.

That antagonistic relationship gave rise to the Grange Movement and eventually to Teddy Roosevelt's trust-busting efforts. It also gave rise to farmer cooperatives — organizations specifically exempted from anti-trust laws so that agricultural producers could work together to aggregate sufficient quantities of a particular crop to have some power in the marketplace.

Growing up in Minnesota, Raymond Plank witnessed the Grange movement firsthand. One of his most vivid childhood memories is of the violence visited on his friends by Pinkerton goons hired by the railroads to break up Grange meetings with guns and axe handles. Plank also saw how marketing cooperatives had helped farmers; he decided it was a model for natural gas producers.

For more than a year and half in the mid-1990s, Apache led a nationwide group of independent producers, their state trade organizations, the Independent Producers Association of America (IPAA), and royalty owners numbering in the thousands in an effort to secure limited exemption from anti-trust laws to enable natural gas producers to form marketing cooperatives.

Opposition came from familiar faces: the major oil companies; pipelines; and most particularly from a new group — natural gas marketers.

The effort got off to a good start when two senior members of the U.S. House Judiciary Committee from Texas — Republican Lamar Smith and Democrat John Bryant — introduced an amendment to the anti-trust laws that would permit the formation of natural gas marketing co-ops. Within weeks, 64 members of Congress had signed on as co-sponsors, including many from the key Judiciary Committee.

It was only then that Apache and its allies discovered the nature and power of the opposition, led by Enron and its well-connected chairman, Ken Lay.

Over the course of the 1990s, Enron contributed more than $5 million in unregulated corporate contributions ("soft money") to both the Democratic and Republican parties. Enron's political action committee (PAC) also contributed millions in hard (regulated) money and Enron officers contributed millions more from their own checkbooks, fattened by excessive compensation and stock options.

Leaders of both parties, including President Bill Clinton, Vice President Al Gore, U.S. Senator Bob Dole, former President George H.W. Bush and then-Texas Governor George W. Bush, each logged many hours in Enron planes and many dollars on the Enron expense accounts.

Ken Lay could play golf with any elected official in the land. And instead of sleeping in the Lincoln bedroom, Lay got a better deal. He hand-picked Hazel O'Leary as President Clinton's energy secretary and she became the point person for Enron around the world, settling disputes with India, working deals in South America, and opening doors in Europe.

Enron had a firm hand on the levers of power, monitored by 63 in-house lobbyists, several dozen contract lobbyists and a governmental affairs budget of over $75 million per year.

In contrast, Apache took a principled stand based on the belief that our representatives would act in accordance with the public good, not the self-interest of a few large contributors. The company did

not make soft money contributions and made limited contributions from its PAC. Apache had one lobbyist, two public relations people and a budget of $300,000 to fight the co-op battle in Washington, in addition to staying active in five other states where Apache conducted business.

Killing the co-op legislation became Priority No. 1 for Enron's Washington office. Whenever Apache's lobbyist visited a Congressional office advocating passage of the bill, two Enron lobbyists would follow.

Enron had help from its competitor-clone, Dynegy. Its Chairman and Chief Executive Officer Chuck Watson sought and attained a seat on IPAA's Executive Committee; from that perch, he arranged for the association's betrayal of the producer co-op movement. Apache later discovered that the IPAA staffer assigned to win passage of the legislation had been a double agent, working with Enron and Dynegy to slow down or kill the bill. In the end, it was the co-op bill's own sponsors who delivered the coup de grâce. These congressmen never requested a committee vote and the legislation died at the end of the session.

The rise and fall of the mega-marketers

By 1997, companies such as Enron, Dynegy, El Paso and others had created entirely new, completely unregulated businesses. Not only did these mega-marketers trade crude oil, natural gas and electricity, they began to dabble in every other commodity. They even began to invent new commodities to trade, such as weather and insurance futures.

The mega-marketers — either single-handedly or in league with one another — soon controlled every major natural gas and electricity market throughout the country. They exploited every weakness in the market structure and made up a few wrinkles of their own.

One scam that had major impact on natural gas producers was manufactured price volatility. Natural gas became the single most volatile commodity traded on any exchange anywhere in the world.

Enron and its fellow travelers, with their massive trading operations, created volatility and then took advantage of it by offering hedging contracts to producers and consumers. Essentially, hedges are insurance policies against unfavorable price movements. For a fee, Enron and other mega-marketers allowed a producer or consumer to pick the price to buy or sell natural gas. Of course, they set the fee, and price never came with a full warranty.

Many producers fell for the scam and turned over hundreds of millions of dollars in fees to play the hedging game. What producers didn't understand was that the very people who were selling the insurance against market volatility were the ones creating that volatility, and the mega-marketers could make the market go up or down whenever it suited their financial purposes.

Having once owned a one-third interest in Dynegy (when it was known as Natural Gas Clearinghouse), and observing how CEO Chuck Watson and his side-kick President Steve Bergstrom operated, Raymond Plank figured out the game they were playing. Apache sold its interest in 1992 and Plank started to express his misgivings aloud.

In February 2002, Plank was invited to participate in a Congressional hearing on the state of the natural gas and electricity markets after Enron's spectacular collapse. He explained that the corruption and market manipulation were not confined to Enron; it was standard operating procedure for all the mega-marketers.

When the subcommittee chairman chided Plank for leveling accusations without the evidence to support his charges, Plank replied, "*You have subpoena power; I don't. I suggest you use it.*"

At the time of the hearing, the second-tier mega-marketers were trying to distinguish themselves from Enron. For a decade, companies such as Dynegy, El Paso and the rest had looked to Enron for leadership; they saw Enron as a role model and copied almost every one of its schemes. Now that Enron had collapsed in a massive accounting fraud, the remaining mega-marketers couldn't get far enough away fast enough. During the spring of 2002, their mantra was they weren't Enron and the California energy crisis was limited to one state and one company.

Their ploy almost worked. Many members of Congress fell for it, including House Energy Committee Chairman Billy Tauzin (R-La.).

In a meeting in April 2002 in the congressman's Capitol Hill committee office, Plank, Steve Farris and other Apaches continued the cannonade against Dynegy and the remaining marketer brethren: All of the mega-marketers were involved in market manipulation; all should be investigated; and all should be indicted and convicted of massive fraud and theft. Furious, Tauzin stormed out of his own office.

While the committee did not take up on Plank's challenge to investigate the market, FERC, the Commodities Futures Trading Commission (CFTC), and the Justice Department did. Spurred by a competing investigation by the California State Senate (aided by Apache), the federal investigations took on a new intensity. What they found was beyond what even Plank thought possible: As many as 20 natural gas trading companies were engaged in a systematic effort to manipulate the index prices of natural gas.

Most natural gas in North America is bought and sold based on a price index such as those published by Platts, owned by McGraw-Hill. Platts' natural gas indexes were considered the industry standard and

over a period of a few years in the 1990s had come to be used in almost every contract and regulatory pronouncement. The natural gas index system pervaded every nook and cranny of the market.

But the prices were rigged. The methodology employed by Platts and other index publishers was amateurish. Index employees would call natural gas traders and ask them the volumes and prices for gas sold at about 70 market hubs around North America. No audits were conducted. No counterparty information was requested and information was never cross-checked or verified.

With no rules or cross-checks, natural gas traders discovered they could report false information, moving the index with impunity at any hub in any direction necessary to help their trading positions.

As one trader later told a newspaper, the practice of providing false information to index publishers was a common, well-known and well-recognized way of conducting business.

Enron took market manipulation to new heights by establishing its own on line trading floor which was little more than a casino. It was Enron's game, Enron was the house, and the house never lost.

After Enron, perhaps the next most egregious actor was American Electric Power (AEP). The CFTC discovered that during a two-year period from 2000 to 2002, AEP had reported 2,800 false trades to just one of Platts' two price index publications. Those 2,800 trades amounted to 78 percent of the trades AEP reported to Platts. CFTC investigators working from subpoenas discovered that AEP had even created special computer software to keep track of all its lies, (aptly named "iFERCbogus.com.").

As before, Apache led a coalition of independent producers and royalty owners on this issue. But this time they reached out to residential and industrial consumers for help, forming the Coalition for Energy Market Integrity and Transparency (EMIT). All the state producer associations joined, as did the National Association of Royalty Owners. From the consumer side, the coalition attracted the National Rural Electric Cooperative Association, representing over 50 million residential users of natural gas and electricity; the American Public Gas Association, comprising municipalities from all over the country that had their own natural gas distribution systems and represented another 25 million natural gas consumers; the National Association of State Utility Consumer Advocates, representing consumer advocates from every state in the union; and the Industrial Energy Consumers of America (IECA), a group of 20 of the largest industrial natural gas users in the United States.

By the time of another congressional hearing in April 2003, the breadth and depth of mega-marketer fraud was plainly evident. Apache, Plank and allies in EMIT no longer could be dismissed as uninformed conspiracy theorists.

The situation presented a difficult choice for the elected and appointed Republican officials who controlled Congress and the Executive Branch because most of them had come to Washington believing that less government was the best government. They wanted to get Washington out of the lives of businessmen. Since most of those true believers populated FERC, that agency failed to rise to the challenge despite the months of revelations and the strong recommendations of its own staff to move forward with increased oversight of the price index system.

The CFTC set the pace by investigating, publicizing and penalizing the bad actors. By the summer of 2004, the CFTC had levied more than $100 million in fines against eight companies. Fifteen companies are still under investigation and CFTC is seeking $336 million for AEP's malfeasance.

Congress moved as well. The addition of the Industrial Energy Consumers of America added a great deal of punch to the Apache-EMIT message. Chairman Tauzin saw the handwriting on the wall when IECA representatives told FERC and the House Energy Committee that increased oversight was necessary. IECA contended that their member companies didn't mind paying even $6 per Mcf for natural gas if they knew that most of that money was going back to producers to find and produce more natural gas. However, under current circumstances they felt that much of the money they paid for gas was being siphoned off by marketers in the middle, and if that didn't change they would have to make business decisions that Congress would not like. One representative reminded Congress and FERC that everything that IECA members manufactured could be imported, so they did have the option of using foreign manufacturing facilities instead of utilizing those in the United States employing American workers. As if to prove the point, Dow Chemical closed a plant in Terrebonne Parish, La., and moved 600 jobs to Germany — not because of cheaper labor costs but because of cheaper energy costs.

Tauzin and U.S. Representatives Joe Barton (R-Texas) and Ed Markey (D-Mass.) inserted a provision in the energy bill requiring FERC to oversee natural gas markets to guard against future manipulation.

The bill passed the House but failed in the Senate by two votes because of a side issue. The energy bill, like so many other important issues, became mired in election-year posturing and the ultimate outcome of the debate was still uncertain in late 2004.

The revelations continue to mount, as do indictments, plea bargains, convictions and substantial fines and penalties. The entire middle of the energy market followed Enron into a tailspin. Investors saw more than $150 billion in market capitalization disappear as the illusory nature of the mega-marketers' businesses was exposed.

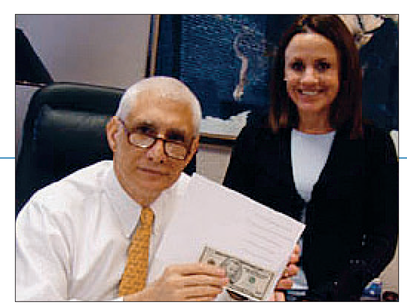
It remains to be seen whether the FERC commissioners finally will realize that sound markets need transparency based on sound rules.

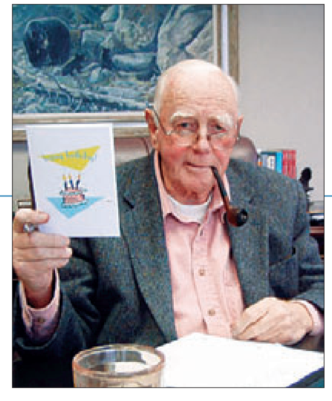
Even so, nearly all of the mega-marketers have now abandoned the natural gas trading business. Most, like Enron, are going back to their roots and have reinvented themselves yet again as pipeline companies. And yet again the pipelines have gone back to their old ways. A new spate of pipeline spin-downs, spin-offs, sales and purchases has led to a new round of transportation rate increases, dramatically higher access fees, a tripling of compression and processing fees and allegations that pipelines are putting the squeeze on producers in an attempt to force them to sell their production to the pipeline's production affiliate. The more things change the more things stay the same.

This time could be different. Producers, encouraged by the successes of Apache and its partners against the mega-marketers, are beginning to stand up to the pipelines. A new battle pitting consumers and producers against the pipelines for access to the markets for natural gas is brewing.

The first person to identify and publicize the thorough corruption of the pipelines and the marketing-trading industry they created was Raymond Plank. And the first company to fight for transparency and reform, despite daunting odds, was Apache. In many ways, it was the company's finest hour (albeit lasting for almost 13 years). The beneficiaries of Apache's feisty courage and outspokenness were the company's shareholders, producers, consumers, and the American taxpayer.

50 YEARS
apache
CORPORATION
December 6, 1954 — December 6, 2004





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"It was gratifying to work alongside talented individuals capturing opportunity as if it might never occur again," said Plank. "That we have been able to grow the company and add shareholder value is attributable entirely to capable, creative and motivated people. Apache is lucky to have them."

He then challenged those capable, creative and motivated people:

"What are you going to do for an encore?"